

Company Registration Number 741598

# **IBM United Kingdom Limited**

## **Financial Statements**

**31 December 2016**

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# **IBM United Kingdom Limited**

## **Financial Statements**

**For the Year Ended 31 December 2016**

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# **IBM United Kingdom Limited**

## **Company Information**

**For the Year Ended 31 December 2016**

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<b>Company registration number</b>	741598
<b>The board of directors</b>	W Kelleher V Khurana T Eagle
<b>Company secretary</b>	I Ferguson
<b>Registered office</b>	PO Box 41 North Harbour Portsmouth Hampshire PO6 3AU
<b>Independent auditors</b>	PricewaterhouseCoopers LLP Chartered Accountants & Statutory Auditors Savannah House 3 Ocean Way Southampton Hampshire SO14 3TJ
<b>Bankers</b>	National Westminster Bank Plc 69 High Street Cosham Hampshire PO6 3DA

# IBM United Kingdom Limited

## Strategic Report

For the Year Ended 31 December 2016

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The directors present their strategic report of IBM United Kingdom Limited ('the company') for the year ended 31 December 2016.

### Review of the business

International Business Machines Corporation ('IBM') is a globally integrated enterprise operating in over 175 countries, bringing innovative solutions to a diverse client base to help solve some of their toughest business challenges. IBM is a global business and technology leader, innovating in research and development to shape the future of society at large. IBM's prized research, development and technical talent around the world works with governments, corporations, academia and business partners on ground breaking real world problems to help make the world work better, make more efficient use of its resources and build a smarter planet.

IBM's strategy, despite the volatility of the information technology industry, has been to consistently deliver superior performance and value to its clients. In 2014, IBM's strategic imperatives were declared around the three main forces behind 'digital': big data and analytics, cloud and engagement. IBM's clients are transforming resulting in new types of interactions between people, organisations and machines. Through these developments, IBM is emerging as more than a hardware, software and services company; IBM is transforming into a cognitive solutions and cloud platform company.

The company's business follows the global strategy in terms of the nature of operations and the broad range of hardware and software solutions, technology services and business consulting to clients in all industries, including small and midsize businesses. In the UK the company creates value for clients and solves business problems through integrated solutions that leverage data, information technology and deep expertise in industries and business processes. IBM solutions typically create value by enabling new capabilities for clients that transform their business and help them engage with their customers and employees in new ways. These solutions draw from an industry leading portfolio of consulting and information technology implementation services, cloud and cognitive offerings, and enterprise systems and software.

The company also has a number of software development laboratories, based at various locations throughout the UK, which develop new products for IBM worldwide and enable IBM to offer its customers current information technology solutions to meet the needs and problems faced by business and industry today.

The IBM group also prides itself as a progressive corporate citizen and proactively engages government organisations, industry bodies, communities and experts on many issues facing business and society, including education, diversity, efficient use of energy and resources and managing impacts on the environment and climate.

The IBM group continues to evolve its global operating model to improve the utilisation of global resources and skills in support of the delivery of its services and solutions to clients. The company is both a beneficiary of global resource skills from overseas as well as providing UK employed expertise to the rest of the IBM group.

# IBM United Kingdom Limited

## Strategic Report

For the Year Ended 31 December 2016

### Review of the business (continued)

	2016 £m	2015 £m	Yr-to-Yr
Revenue	3,899.2	3,657.7	6.6 %
Gross profit margin	4.8 %	7.7 %	(37.7)%
Administrative expenses and other operating income	(121.3)	(144.3)	(15.9)%
Operating profit	65.0	138.0	(52.9)%
Profit before income tax	125.7	190.8	(34.1)%

*The full trading results and cash flows for the year and the company's financial position at the end of the year are shown on pages 13 to 18 of the financial statements.*

Total revenue increased by 6.6 percent compared to 2015. Revenue from the core business units ('Home Revenue' per note 3 of the financial statements) increased by 7.8 percent. Export revenues, which are derived from sales of services, including research and development, to companies in the IBM group overseas, increased by 2.1 percent compared to 2015.

Gross profit margins decreased by 2.9 points year on year. The principal driver for this decline were (1) a reduction in hardware sales and (2) an additional £51.0 million of charges for resources provided by IBM India during the years 2009 to 2015 resulting from a recent conclusion of an audit by the Indian tax authorities.

The decline in operating profit and profit before taxation is mainly driven by the decline in the absolute gross profit and a decline in foreign currency exchange gains of £9.7 million. Write offs charged to administrative expenses in respect of liquidations of £47.4 million (2015: £31.6 million) is off set by dividends received from the liquidated entities prior to liquidation of £46.4 million (2015: £31.1 million).

The company delivered £8.5 million in cash flow from operating activities, a decrease of £125.0 million compared to 2015. Income tax of £84.1 million has been paid during the year (2015: £1.0 million). Cash generated from operations has decreased by £41.5 million.

In June 2017 the company agreed the closure of certain ongoing tax audits with Her Majesty's Revenue and Customs ('HMRC'). This has resulted in a net prior year charge for income taxes of £36.4 million in respect of additional taxes due. During 2016 the company made payments on account to HMRC of £84.1 million in respect of this and on behalf of other IBM group entities.

Cash and cash equivalents has decreased from £1,925.6 million to £473.8m. In December 2016 £1,400.0 million was placed on a two year fixed term deposit with IBM International Treasury Services Company.

The financial strength of the company has improved year on year to a closing net asset position of £2,967.2 million from £2,519.7 million in 2015 mainly driven by an increase in the retirement benefit asset to £797.7 million (2015: £279.6 million).

# IBM United Kingdom Limited

## Strategic Report

For the Year Ended 31 December 2016

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### Principal risks and uncertainties

The key business risks affecting the company are considered to relate to the economic environment, technology obsolescence and the competitive environment.

#### *Economic Environment*

If overall demand for systems, software and services changes, whether due to general economic conditions or a shift in corporate buying patterns, sales performance could be impacted.

The company aims to maintain a steady income stream through an economic cycle by having a mixture of offerings with long-term contractual income streams as well as transaction based sales. The company also has the ability to sell its skilled resource to other companies within the IBM group.

The company earns a minority, yet material, proportion of its revenue from providing its skilled resources to IBM group entities in other European Union ('EU') countries. On 23 June 2016 the electorate of the United Kingdom voted to leave the European Union. The Directors do not anticipate any impact in the short term as, under Article 50 of the Lisbon Treaty, the exit process can take up to two years. However, longer term there is a small risk to the company's ability to provide its resources to other IBM group companies in the EU. The risk is viewed as small because the IBM Group have an established track record of deploying their resources on a global basis whilst complying with local visa requirements or restrictions.

#### *Technology Obsolescence*

Information Technology solutions are rapidly evolving and, in order to stay relevant to our clients, IBM spends over \$5 billion a year on research and development of new products and solutions. The company not only benefits from this research and development work but it also provides skilled UK resources to IBM in support of this innovation work.

#### *Competitive Environment*

The company operates in a highly competitive market against many large established providers as well as new providers entering the UK market.

The company continues to transform itself to remain price competitive in the market as well as promoting our ability to innovate and integrate for our clients. The directors consider this to be a unique proposition which sets IBM apart from its competition.

### Key performance indicators

The company is managed by the UK board along with other UK IBM entities. The performance and results for all UK entities are analysed on a worldwide IBM measurement basis, at a business unit and sector level. For this reason the directors of the company believe that analysis using key performance indicators is not appropriate for an understanding of the development, performance or position of the business shown in these financial statements. The development, performance and position of International Business Machines Corporation, which includes the UK entities, is discussed on pages 36 to 55 of the Corporation's annual report for the year ended 31 December 2016, which does not form part of this report.

# IBM United Kingdom Limited

## Strategic Report

For the Year Ended 31 December 2016

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### Future developments

Despite the challenges faced as a result of the difficult global economic environment, the company is well placed to continue to deliver value to its clients and consistent financial results via the ongoing business transformation, new products and offerings and expansion of the business through acquisition.

Signed on behalf of the board



W Kelleher  
Director

17 July 2017

# IBM United Kingdom Limited

## Directors' Report

For the Year Ended 31 December 2016

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The directors present their annual report and the audited financial statements of IBM United Kingdom Limited ('the company') for the year ended 31 December 2016.

A review of the business including the results for the year, details of principal risks and uncertainties, key performance indicators and future developments of the company's business are covered in the Strategic Report.

The company has one overseas branch, which is based in Gibraltar.

### Dividends

The directors have not recommended a dividend (2015: £nil).

### Events after the reporting date

Subsequent to year end, the company repurchased 3 preference shares for cash consideration of £120 million.

### Financial risk management

The company is exposed to a variety of financial risks as a result of its operations which include the effects of changes in market prices, credit risk, liquidity risk, interest rate risk and currency risk. The company has a strong risk management programme in place aligned to the worldwide programme of the company's ultimate parent company, International Business Machines Corporation.

#### Price risk

The financial risk posed by external vendors is managed and controlled by IBM's central procurement function. Procurement is the only business unit in IBM which is authorised to make financial commitments to external vendors. The unit has responsibility for achieving overall value for IBM in terms of supplier selection at the optimum price. All procurement activities are carried out under worldwide IBM guidelines. The financial risk posed by sales price is managed through a central pricing team. The business only agrees to sign contracts once the appropriate pricing approval has been obtained.

#### Credit risk

The company has in place policies that require appropriate credit checks on potential customers before sales are made, and regular reviews of credit limits on existing customers are carried out. The company also manages its credit risk by factoring certain trade receivables. Any losses incurred in the collection of factored debt sold are not borne by the company.

#### Liquidity and interest rate risk

If required, the company has access to internal funding from IBM International Treasury Services Company ('the Treasury Centre') in Ireland. The Treasury Centre is ultimately funded by International Business Machines Corporation. Any borrowing is treated as short term debt finance. The company did not have any short term or long term debt finance at 31 December 2016 or 2015. Currently the company has a net cash position (see note 20) and loans this cash to the Treasury Centre. Given the cash position, liquidity risk is minimal.

As the company invests or borrows cash balances internally, it operates daily in either a cash or overdraft position with no fixed period debt in place. Interest is paid or earned on the daily balance using the variable one month interest rate as the base.

#### Currency risk

As part of International Business Machines Corporation's global hedging strategy the company operates a 12 month forward rolling hedging programme with a non UK group undertaking to hedge a proportion of its US dollar costs arising from transactions with both related companies and suppliers.



# **IBM United Kingdom Limited**

## **Directors' Report**

**For the Year Ended 31 December 2016**

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### **Financial instruments**

Details of the company's financial risk management objectives and policies, including the use of financial instruments, are included in note 23 to the financial statements.

### **Research and development**

Specific product development projects are carried out at laboratories, in various locations throughout the UK, on behalf of International Business Machines Corporation and its subsidiaries. The expenditure incurred on these projects in the year of £158.7 million (2015: £169.1 million) was recharged to International Business Machines Corporation.

### **Acquisitions**

On 26 February 2016 the company acquired 100% of the share capital of Silverpop Systems Limited for £24.4 million from IBM United Kingdom Holdings Limited.

On 18 March 2016 the company acquired 100% of the share capital of Optevia Limited for £6.7 million from the directors of Optevia Limited.

On 29 June 2016 the company acquired 100% of the share capital of Cleversafe UK Limited for £3.0 million from Cleversafe Inc.

On 30 December 2016 the company acquired 100% of the share capital of Resilient Systems Europe Limited for £0.1 million from International Business Machines Corporation.

# IBM United Kingdom Limited

## Directors' Report

For the Year Ended 31 December 2016

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### Changes in pension plans

The company initiated legal proceedings in May 2010 before the High Court in London against the IBM UK Pensions Trustee and two representative beneficiaries of the IBM UK Plans. The company was seeking a declaration that it acted lawfully both in notifying the Trustee of the IBM UK Pension Plans that it was closing its UK defined benefit plans to future accruals for most participants and in implementing the company's new retirement policy. On 4 April 2014, the High Court acknowledged that the changes made to its UK defined benefit plans were within IBM's discretion, but ruled that IBM breached its implied duty of good faith both in implementing these changes and in the manner in which it consulted with employees.

Proceedings to determine remedies were held on 21 July 2014 and, on 20 February 2015, the High Court held that for IBM to make changes to accruals under the plan would require a new consultation of the participants, but to make other changes (including to the early retirement policy) would not require such consultation.

IBM United Kingdom Limited has appealed both the breach and remedies judgements, and the hearing before the Court of Appeal took place in May 2017. The Court of Appeal has not delivered its judgment. There are a wide range of potential outcomes in this litigation, and no certainty as to outcome. If the appeal is unsuccessful, and subject to any further appeals, the Court's rulings would require IBM to reverse one or more of the changes made retroactive to their effective dates. Having taken appropriate advice from our actuaries, our best estimate of the income statement charge that would be incurred should the company's appeal be unsuccessful is £235 million.

IBM believes that it has reasonable prospects of success on appeal, and, therefore, has not made any adjustment to the financial statements.

In addition, IBM United Kingdom Limited is a defendant in approximately 290 individual actions brought since early 2010 by participants of the defined benefits plans who left the company. These actions, which allege constructive dismissal and age discrimination, are pending before the Employment Tribunal in Southampton UK. We do not believe it probable that a material economic outflow will result from the Employment Tribunals and therefore no adjustments have been made to the financial statements.

### Employee involvement

Employees receive information on the financial and economic factors affecting the performance of the business, along with product announcements, details of organisational changes and all other matters of direct concern and interest to them. This information is provided by the internal publication 'Link.me', and by their managers. The views of the employees are obtained from opinion surveys, at departmental meetings and through direct contact with their managers.

Consultation bodies, consisting of representatives of the employee population who are elected to represent the views of employees and consult with the company on major areas of interest, are formed as and when required.

The company continues to support employee share ownership of International Business Machines Corporation, through established employee share schemes, membership of which is service related. In addition, all IBM employees have the opportunity to purchase International Business Machines Corporation shares through the IBM Employee Share Purchase Plan, which is intended to encourage employees to take active ownership in IBM and to be committed to its long-term success.

In the United Kingdom, IBM launched the On Demand Community Challenge in 2003. The Community Challenge concept is for teams of IBM volunteers to work with not-for-profit organisations and schools to deliver projects such as promoting literacy and introducing young people to technology. Once a year, IBM employees nominate charitable projects that utilise On Demand Community tools and IBM skills to deliver projects working with local communities across the United Kingdom.

# IBM United Kingdom Limited

## Directors' Report

For the Year Ended 31 December 2016

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### Disabled employees

In common with all others, disabled persons are given full consideration in respect of selection, continued employment, training, career development and promotion. If members of staff become disabled the company continues employment, either in the same or alternative position, with appropriate retraining being given if necessary.

### Directors' indemnity and insurance

As permitted by the Articles of Association, the directors have the benefit of an indemnity which is a qualifying third party indemnity provision as defined by Section 234 of the Companies Act 2006. The company has granted this indemnity in favour of the directors of the company as is permitted by Section 232-235 of the Companies Act 2006. The indemnity was in force throughout the last financial year and is currently in force. International Business Machines Corporation has purchased Directors' and Officers' liability insurance cover for the directors against liabilities arising in relation to the company, as permitted by the Companies Act 2006. This insurance does not cover criminal activity.

### Directors

The directors who served the company during the year and up to the date of signing these financial statements were as follows:

D Stokes	(resigned 5 June 2017)
N Hill	(resigned 4 June 2016)
T Eagle	
S Leonard	(resigned 1 April 2017)
S Smith	(resigned 14 February 2017)
S Tickle	(resigned 8 February 2017)
V Khurana	(appointed 20 May 2016)
W Kelleher	(appointed 7 June 2017)

### Statement of disclosure of information to auditors

Each of the persons who are directors at the date of approval of this report confirm that:

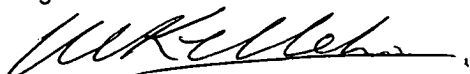
- there is no relevant audit information of which the company's auditors are unaware, and
- the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

### Independent auditors

PricewaterhouseCoopers LLP are deemed to be re-appointed under section 487(2) of the Companies Act 2006.

Signed on behalf of the board



W Kelleher  
Director  
17 July 2017

# **IBM United Kingdom Limited**

## **Statement of Directors' Responsibilities**

**For the Year Ended 31 December 2016**

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The directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

# **IBM United Kingdom Limited**

## **Independent Auditors' Report to the Members of IBM United Kingdom Limited**

**For the Year Ended 31 December 2016**

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### **Report on the financial statements**

#### **Our opinion**

In our opinion, IBM United Kingdom Limited's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 December 2016 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

#### **What we have audited**

The financial statements, included within the Financial Statements (the "Annual Report"), comprise:

- the Statement of Financial Position as at 31 December 2016;
- the Income Statement and Statement of Comprehensive Income for the year then ended;
- the Statement of Cash Flows for the year then ended;
- the Statement of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union and applicable law.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

### **Opinion on other matters prescribed by the Companies Act 2006**

In our opinion, based on the work undertaken in the course of the audit:

- information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

### **Other matters on which we are required to report by exception**

#### **Adequacy of accounting records and information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

# IBM United Kingdom Limited

## Independent Auditors' Report to the Members of IBM United Kingdom Limited

For the Year Ended 31 December 2016

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### Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

### Responsibilities for the financial statements and the audit

#### Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 10, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK & Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

#### What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.



Robert Girdlestone (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants & Statutory Auditors  
Southampton

19 July 2017

# IBM United Kingdom Limited

## Income Statement

For the Year Ended 31 December 2016

	Note	2016 £m	2015 £m
Revenue	3	3,899.2	3,657.7
Cost of sales	4	(3,712.9)	(3,375.4)
<b>Gross profit</b>		<b>186.3</b>	<b>282.3</b>
Administrative expenses	4	(139.9)	(146.1)
Other operating income		18.6	1.8
<b>Operating profit</b>		<b>65.0</b>	<b>138.0</b>
Net interest on defined benefit asset	24	11.1	9.2
Income from investments	14	46.4	38.5
Other finance income	9	8.9	10.3
Other finance costs	10	(5.7)	(5.2)
<b>Profit before income tax</b>		<b>125.7</b>	<b>190.8</b>
Income tax expense	11	(64.5)	(41.0)
<b>Profit for the year</b>		<b>61.2</b>	<b>149.8</b>

The notes on pages 19 to 83 form part of these financial statements.

# IBM United Kingdom Limited

## Statement of Comprehensive Income

For the Year Ended 31 December 2016

	Note	2016 £m	2015 £m
Profit for the year		61.2	149.8
Other comprehensive income / (expense)			
Items that will not be reclassified to profit or loss			
Actuarial gain / (loss) on defined benefit pension schemes	24	439.3	(33.0)
Deferred tax in respect of defined benefit pension schemes	16	(76.5)	6.4
Other comprehensive income / (expense) for the year, net of income tax		362.8	(26.6)
Total comprehensive income for the year		424.0	123.2

The notes on pages 19 to 83 form part of these financial statements.



# IBM United Kingdom Limited

## Statement of Changes in Equity

For the Year Ended 31 December 2016

	Note	Share capital £m	Share premium £m	Retained earnings £m	Total equity £m
<b>At 1 January 2015</b>		956.4	719.3	725.3	2,401.0
Profit for the financial year		-	-	149.8	149.8
Actuarial loss on defined benefit pension schemes	24	-	-	(33.0)	(33.0)
Deferred tax in respect of defined benefit pension schemes	16	-	-	6.4	6.4
<b>Total comprehensive income</b>		-	-	123.2	123.2
Recognition of share-based payments	25	-	-	(3.6)	(3.6)
Deferred tax in respect of share-based payments	16	-	-	(0.9)	(0.9)
<b>Total transactions with owners</b>		-	-	(4.5)	(4.5)
<b>At 31 December 2015</b>		956.4	719.3	844.0	2,519.7
Profit for the financial year		-	-	61.2	61.2
Actuarial gain on defined benefit pension schemes	24	-	-	439.3	439.3
Deferred tax in respect of defined benefit pension schemes	16	-	-	(76.5)	(76.5)
<b>Total comprehensive income</b>		-	-	424.0	424.0
Issue of preference shares	31	-	24.4	-	24.4
Recognition of share-based payments	25	-	-	(0.9)	(0.9)
<b>Total transactions with owners</b>		-	24.4	(0.9)	23.5
<b>At 31 December 2016</b>		956.4	743.7	1,267.1	2,967.2

The notes on pages 19 to 83 form part of these financial statements.

# IBM United Kingdom Limited

## Statement of Financial Position

As at 31 December 2016

	Note	2016 £m	2015 £m
<b>Non-current assets</b>			
Property, plant and equipment	12	237.7	246.8
Intangible assets	13	312.2	282.2
Investments in subsidiaries	14	406.8	450.0
Deferred tax assets	16	-	49.8
Finance receivables	17	11.5	5.6
Other receivables	19	122.6	129.3
Receivables from related parties	30	1,400.0	-
Retirement benefit asset	24	797.7	279.6
		<b>3,288.5</b>	<b>1,443.3</b>
<b>Current assets</b>			
Inventories	18	12.5	1.5
Finance receivables	17	12.6	6.7
Trade and other receivables	19	351.2	339.5
Receivables from related parties	30	1,242.3	2,682.2
Derivatives from related parties	30	21.2	9.0
Cash and cash equivalents	20	6.8	9.8
		<b>1,646.6</b>	<b>3,048.7</b>
<b>Total assets</b>		<b>4,935.1</b>	<b>4,492.0</b>
<b>Non-current liabilities</b>			
Deferred revenue		(131.6)	(135.3)
Deferred tax liability	16	(56.1)	-
Provisions for liabilities and charges	21	(7.4)	(14.3)
Other payables	22	(11.2)	(10.4)
		<b>(206.3)</b>	<b>(160.0)</b>
<b>Current liabilities</b>			
Deferred revenue		(388.2)	(350.2)
Provisions for liabilities and charges	21	(13.2)	(9.9)
Income tax liabilities		(22.1)	(87.0)
Trade and other payables	22	(405.9)	(452.3)
Payables to related parties	30	(932.2)	(912.9)
		<b>(1,761.6)</b>	<b>(1,812.3)</b>
<b>Total liabilities</b>		<b>(1,967.9)</b>	<b>(1,972.3)</b>
<b>Net assets</b>		<b>2,967.2</b>	<b>2,519.7</b>

The notes on pages 19 to 83 form part of these financial statements.

# IBM United Kingdom Limited

## Statement of Financial Position

As at 31 December 2016

	Note	2016 £m	2015 £m
<b>Issued capital and reserves</b>			
Share capital	31	956.4	956.4
Share premium	31	743.7	719.3
Retained earnings		1,267.1	844.0
<b>Total equity</b>		<b>2,967.2</b>	<b>2,519.7</b>

The financial statements on pages 13 to 83 were approved by the directors and authorised for issue on 17 July 2017, and are signed on their behalf by:



W Kelleher  
Director

Company registration number: 741598

The notes on pages 19 to 83 form part of these financial statements.

# IBM United Kingdom Limited

## Statement of Cash Flows

For the Year Ended 31 December 2016

	Note	2016 £m	2015 £m
<b>Net cash inflows from operating activities</b>	29	8.5	133.5
<b>Cash flows from investing activities</b>			
Payments to acquire property, plant and equipment		(86.2)	(95.1)
Proceeds from the sale of property, plant and equipment		27.6	3.7
Cash acquired with purchase of business		2.6	-
Payments to acquire investments in subsidiaries		(9.8)	-
<b>Net cash outflow from investing activities</b>		(65.8)	(91.4)
<b>Cash flows from financing activities</b>			
Amounts placed on long term deposit		(1,400.0)	-
Interest received		5.5	6.2
<b>Net cash (outflows) / inflows from financing activities</b>		(1,394.5)	6.2
<b>Net (decrease) / increase in cash and cash equivalents</b>		(1,451.8)	48.3
Cash and cash equivalents at beginning of year		1,925.6	1,877.3
<b>Cash and cash equivalents at end of year</b>	20	473.8	1,925.6

Cash and cash equivalents are reconciled to the statement of financial position in note 20.

The notes on pages 19 to 83 form part of these financial statements.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies

#### **Basis of preparation**

IBM United Kingdom Limited (the 'company') is a private limited company and is incorporated and domiciled in the United Kingdom and registered in England and Wales under the Companies Act 2006. These financial statements have been prepared under the historical cost convention with the exception of certain items which are measured at fair value as disclosed in the accounting policies below. These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, International Financial Reporting Standards Interpretations Committee interpretations and as applied in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

These financial statements contain information about IBM United Kingdom Limited as an individual company and do not contain consolidated financial information as the parent of a group. The company is exempt under section 401 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertakings are included by full consolidation in the publicly available consolidated financial statements of its ultimate parent company, International Business Machines Corporation, incorporated in the United States of America.

The principal accounting policies adopted in the preparation of the financial statements are set out below. The policies have been applied consistently to all years presented, unless otherwise stated. The preparation of financial statements in compliance with IFRSs requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the company's accounting policies. The areas where significant judgements and estimates have been made in preparing the financial statements are disclosed in note 2 to the financial statements.

The financial statements have been prepared on a going concern basis.

#### **International Financial Reporting Standard No. 8 "Operating Segments" (IFRS 8)**

The company is excluded from the scope of IFRS 8 "Operating Segments" and has not voluntarily prepared analysis of operating segments within the notes to these financial statements.

#### **New and amended standards adopted by the company**

The following standards, interpretations and amendments have been adopted in the financial statements for the first time for the year beginning 1 January 2016:

IAS1, Presentation of Financial Statements (disclosure initiative amendments). This does not have a material impact on the company's financial statements.

IAS 27, Separate Financial Statements (equity method). This does not have a material impact on the company's financial statements.

IAS 16, Property Plant and Equipment (clarification of acceptable methods of depreciation). This does not have a material impact on the company's financial statements.

IAS 38, Intangible Assets (clarification of acceptable methods of amortisation). This does not have a material impact on the company's financial statements.

Annual improvements 2014 to IFRSs; endorsed for 1 January 2016, to implement a number of minor changes to IFRSs, primarily to remove inconsistency and to clarify wording.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### **New standards, interpretations and amendments not yet effective and not early adopted by the company**

The following new standards, interpretations and amendments which have not been applied in these financial statements, will or may have an effect on the company's future financial statements:

IFRS 9, Financial Instruments (2014). This is effective for the year ended 31 December 2018 and has not been early adopted.

IFRS 15, Revenue from Contracts with Customers. This is effective for the year ending 31 December 2018 and has not been early adopted.

There are no other new standards, interpretations or amendments not yet effective or endorsed by the European Union which are expected to have a material impact on the future financial statements of the company.

#### **Revenue recognition**

Revenue, including intercompany revenue, is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and sales related taxes.

The company recognises revenue only if it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably. The company recognises revenue when it has persuasive evidence of an arrangement, delivery has occurred, the sales price is fixed or determinable and the collectability is reasonably assured. Delivery does not occur until products have been shipped or services have been provided to the client, risk of loss has transferred to the client and the client acceptance has been obtained, client acceptance provisions have lapsed or the company has objective evidence that the criteria specified in the client acceptance provisions have been satisfied. No revenue is recognised if there are significant uncertainties regarding recovery of consideration due, associated costs or the company's continuing involvement with goods.

#### *Hardware and Leases*

Revenue from hardware sales or finance leases is recognised when the product is shipped to the client and when the significant risk and rewards of ownership have been transferred to the buyer. Any cost of warranties and remaining obligations that are inconsequential or perfunctory are accrued when the corresponding revenue is recognised. Revenue from rentals and operating leases is recognised on a straight-line basis over the term of the rental or lease (see the Leasing accounting policy).

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### Revenue recognition (continued)

##### *Software*

Revenue from perpetual (one-time charge) licensed software is recognised at the inception of the licence term. Revenue from term (monthly licence charge) arrangements is recognised on a subscription basis over the period that the client is using the licence. Revenue from maintenance, unspecified upgrades and technical support is recognised over the period such items are delivered.

##### *Services*

The company's primary services offerings include information technology (IT) datacenter and business process transformation outsourcing, Cloud Services, application management services, technology infrastructure and system maintenance, web hosting, and the design and development of complex IT systems to a client's specifications (design and build). These services are provided on a time and materials basis, as a fixed price contract or as a fixed price per measure of output contract, and the contract terms generally range from less than one year to ten years. Revenue from IT datacentre and business process transformation outsourcing contracts is recognised in the year the services are provided using either an objective measure of output or a straight-line basis over the term of the contract. Under the output method, the amount of revenue recognised is based on the services delivered in the year as stated in the contract.

Revenue from Cloud Services (SaaS, IaaS, PaaS, BPaaS) is recognised on a consumption basis.

Revenue from application management services, technology infrastructure and system maintenance, and web hosting contracts is recognised on a straight-line basis over the term of the contract.

Revenue from time and material contracts is recognised at the contractual rates as labour hours are delivered and direct expenses are incurred. Revenue related to extended warranty and product maintenance contracts is deferred and recognised on a straight-line basis over the delivery period.

Revenue from fixed-price design and build contracts is recognised where the outcome of a contract can be reliably estimated, and revenue and costs are recognised under the percentage of completion (POC) method. Under the POC method, revenue is recognised based on the costs incurred to date as a percentage of the total estimated costs to fulfil the contract. If circumstances arise that may change the original estimates of revenues, costs, or extent of progress toward completion, then revisions to the estimates are made. These revisions may result in increases or decreases in estimated revenues or costs, and such revisions are reflected in the income statement in the year in which the circumstances that give rise to the revision become known by management.

The company performs ongoing profitability analysis of its services contracts in order to determine whether the latest estimates, such as revenue, costs of sales or profits, require updating. If, at any time, these estimates indicate that the contract will be unprofitable, the entire estimated loss for the remainder of the contract is recorded immediately.

In some of the company's services contracts the company bills the client prior to performing the services. These balances are held as deferred income in the statement of financial position until the service is performed. In other services contracts the company performs the services prior to billing the client. These balances are held as amounts recoverable on contracts in the statement of financial position until the client is billed. Billings usually occur in the month after the company performs the services or in accordance with specific contractual provisions.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### Revenue recognition (continued)

##### *Multiple-element arrangements*

The company enters into multiple-element software and non-software related revenue arrangements, which may include any combination of services, software, hardware and/or financing. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met:

##### *Software related revenue arrangements*

The functionality of the delivered element(s) is not dependent on the undelivered element(s).

There is a fair value of the undelivered element(s).

Delivery of the delivered element(s) represents the culmination of the earnings process for that element(s).

##### *Non-software related revenue arrangements*

The delivered item(s) has value to the client on a standalone basis.

There is objective and reliable evidence of the fair value of the undelivered item(s).

If the arrangement includes a general right of return of the delivered item(s), the delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the company.

If these criteria are not met, revenue is deferred until the earlier of when such criteria are met or when the last undelivered element is delivered. If there is objective and reliable evidence of fair value for all units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative fair value. There may be cases, however, in which there is objective and reliable evidence of fair value of the undelivered item(s) but no such evidence for the delivered item(s). In those cases, the residual method is used to allocate the arrangement consideration. Under the residual method, the amount of consideration allocated to the delivered item(s) equals the total arrangement consideration less the aggregate fair value of the undelivered item(s). The revenue policies described above are then applied to each unit of accounting, as applicable.

#### **Other finance income**

Finance income represents interest income which is recognised on an accruals basis using the effective interest rate method.



# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### **Leasing**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

##### *The company as lessor*

Amounts due under finance leases are recorded as finance receivables at the amount of the company's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the company's net investment outstanding in respect of the leases.

Rental income from operating leases is recognised on a straight-line basis over the term of the lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

##### *The company as lessee*

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

#### **Administrative expenses**

Administrative expenses are recognised in the income statement as incurred. Administrative expenses include selling expenses, salaries, office supplies, non-income taxes, insurance and office rental.

#### **Research and development**

Costs of product development are recharged to the ultimate parent company, International Business Machines Corporation.

#### **Deferred transition costs**

Costs related to delivering services under long-term contractual arrangements, including costs relating to bid and proposal activities, are expensed as incurred.

Non-recurring costs which are directly incurred in the initial transition and transformation stages of a specific outsourcing contract are capitalised as an asset under the heading 'Deferred transition costs'. These consist of transition and set up costs related to the installation of systems and processes and are amortised on a straight line basis over the remaining life of the contract. The company performs periodic reviews to assess the recoverability of the deferred costs by comparing the minimum remaining contractual net cash inflows to the unamortised contract costs. If such minimum contractual net cash inflows are not sufficient to recover the unamortised costs, an impairment is recognised. Any impairment of deferred costs is included within the heading 'cost of sales'.

#### **Finance costs**

Finance costs represent interest on bank overdrafts and short term borrowings and are accounted for on an accruals basis.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### **Foreign currencies**

The financial statements of the company are presented in British Pounds Sterling, which is the functional currency of the company.

Transactions denominated in foreign currencies are translated at the rate prevailing at the transaction date. Foreign exchange differences are recognised in the income statement in the year of settlement of these items.

At each reporting date, monetary items denominated in currencies other than British Pounds Sterling are retranslated at the rates prevailing at the reporting date. The resulting foreign exchange differences are recognised in the income statement for the year.

#### **Employee benefits**

Provision is made for benefits accruing to employees in respect of wages and salaries and annual leave when it is probable that settlement will be required and they are capable of being measured reliably. Provisions made in respect of employee benefits expected to be settled within 12 months are measured at their nominal values using the remuneration rate expected to apply at time of settlement.

#### *Defined contribution retirement plans*

Contributions to defined contribution retirement plans are recognised as an expense when the employees have rendered services entitling them to the contributions.

#### *Defined benefit retirement plans*

The amount recognised in the statement of financial position in respect of defined benefit retirement benefit plans is the fair value of plan assets less the present value of the defined benefit obligation. Any asset resulting from this calculation is limited to the present value of benefits accruing to the company available in the form of refunds and reductions in future contributions to the plan. The defined benefit obligation is calculated by independent actuaries using the projected unit credit method with actuarial valuations carried out at the end of each annual reporting period. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that have terms to maturity approximating to the terms of the related pension obligation.

Remeasurements are charged or credited to equity in other comprehensive income in the period in which they arise.

Service cost and net interest expense on net liability are recognised immediately in the income statement as employee benefits expense and finance cost, respectively.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### Share based payments

##### *Share options*

The company has an equity settled share option scheme. Share options of International Business Machines Corporation are granted to certain employees (including key management personnel) of the company. The rights to these options are granted by International Business Machines Corporation, the ultimate parent company. The fair value of the employee services received in exchange for the grant of share options is recognised as an expense with a corresponding adjustment to equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the effect of any non-market based vesting conditions. Non-market based vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each reporting date, the company revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of the original estimates, if any, in the income statement for the period, and a corresponding adjustment to retained earnings, as the company does not have a separate equity compensation reserve arising on the issue of share-based payments.

Fair value is measured using the Black-Scholes pricing model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

As per the terms of the arrangement with International Business Machines Corporation, the company is required to compensate International Business Machines Corporation for the difference between the market value of the underlying shares on exercise date and the proceeds from exercise of the share options. This intercompany charge is denominated in US Dollars based on the US Dollar market value of the underlying shares and exercise price. Foreign exchange differences arising on the retranslation of the balance outstanding at each reporting date and at the date of settlement are recognised in the income statement for the period. The intercompany charge is offset to equity against retained earnings.

##### *Share awards*

Share awards are equity awards paid out in International Business Machines Corporation shares after a period of time, generally vesting against service or performance conditions. The fair value of each share award is measured at the market price of International Business Machines Corporation shares on the date of grant.

##### *Employee Share Purchase Plan*

International Business Machines Corporation also provides an employee share purchase plan (ESPP), enabling eligible participants worldwide to purchase full or fractional common shares in International Business Machines Corporation through payroll deductions at a 5% discount to the market price. For purchases prior to 1 April 2005, employees obtained a 15% discount on the market price of the shares. Any discount provided to the company's employees under the ESPP is considered compensation expense.

#### **Taxation**

Income tax expense represents the current tax calculated on taxable profits for the year, any adjustments in respect of prior periods and the deferred tax charge or credit for the year.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### Taxation (continued)

The current tax is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that have been enacted or substantively enacted and that are expected to apply in the year when the liability is settled or the asset realised. Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

#### Property, plant and equipment

Property, plant and equipment held for use in the supply of goods or services, or for administrative purposes, are stated in the statement of financial position at cost less any accumulated depreciation and accumulated impairment losses.

The depreciable amount of an asset is determined after deducting its residual value. The residual value of an asset is the estimated amount that the company would obtain from the disposal of the asset, after deducting the estimated cost of disposal.

Depreciation is charged so as to write off the cost of assets less their residual value over their estimated useful lives, using the straight-line method. The estimated useful lives used in the calculation of depreciation are as follows:

Buildings	5 - 50 years
Plant and equipment	1.5 - 7 years
Fixtures and fittings	5 - 15 years

Depreciation is not charged on land.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### **Property, plant and equipment (continued)**

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement for the year.

#### **Investments in subsidiaries**

Investments in subsidiaries are initially recorded at cost, considered to be equal to the fair value of the company acquired. Post transfer of trade from the subsidiary to IBM United Kingdom Limited a transfer is made from investments to goodwill representing the difference between the fair value of the company acquired and the predecessor book value of the net assets. Investments in subsidiaries are tested annually for impairment and carried at cost less accumulated impairment losses.

#### **Intangible assets**

Intangible assets, other than goodwill, represent the fair value of identifiable assets purchased as part of the acquisition of the trade and associated assets and liabilities of fellow subsidiary undertakings. Intangible assets are amortised on a straight line basis over their finite useful life of between 6 and 8 years. Amortisation of intangible assets is included in administrative expenses in the income statement.

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets of the acquired subsidiary at the date of acquisition which are subsequently transferred in to the company. Goodwill is deemed to have an indefinite life and is tested annually for impairment and carried at cost less accumulated impairment losses.

#### **Impairment of assets**

Investments in subsidiaries and intangible assets are reviewed annually for impairment. If the carrying amount exceeds the recoverable amount an impairment loss is recognised in the income statement for the difference. The recoverable amount is the higher of the asset's fair value less costs to sell and the value in use. For the purposes of assessing impairments, assets are grouped at the lowest levels for which there are identifiable cash flows (i.e. cash generating units, 'CGU's'). All ongoing trade within the acquired subsidiaries is transferred to the company immediately following acquisition. Accordingly, the directors consider there to be a single CGU, being the business of the company as a whole.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or CGU) in prior years. A reversal of an impairment loss is recognised immediately in the income statement.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### **Inventories**

Finished goods and goods held for resale are stated at the lower of cost and net realisable value.

Costs comprise direct materials and, where applicable, those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average cost method.

Provision is made where necessary for obsolete, slow moving and defective stocks.

#### **Financial instruments**

##### *Classes of financial instruments*

The company considers the following to be its classes of financial assets: cash at bank; derivative assets; finance receivables; trade and other receivables; and receivables from related parties. The following financial liabilities are presented as separate classes of financial liabilities: derivative liabilities; trade and other payables and payables to related parties.

Financial assets and financial liabilities are recognised initially at fair value, plus directly attributable transaction costs, in the company's statement of financial position when the company becomes party to the contractual provisions of the instrument. In determining the fair value of its financial instruments, the company uses a variety of methods and assumptions that are based on market conditions and risks existing at each reporting date. For the majority of financial instruments, standard market conventions and techniques such as discounted cash flow analysis, replacement cost and termination cost are used to determine fair value. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realised.

#### **Financial assets**

##### *Classification*

Financial assets are classified into the following specified categories: financial assets 'at fair value through profit or loss' (FVTPL); and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. There are no assets available for sale and no transfers between categories.

##### *Financial assets at fair value through profit and loss*

Financial assets at fair value through profit or loss (FVTPL) are financial assets held for trading. A FVTPL financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### Financial instruments (continued)

##### *Derivative financial assets*

A financial asset is classified as held for trading if:

- It has been acquired principally for the purpose of selling it in the near term; or
- On initial recognition it is part of a portfolio of identical financial instruments that the company manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognised in the income statement. Gains and losses are included in the 'cost of sales' line item in the income statement. Fair value is determined in the manner described in note 23.

##### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those with maturities greater than 12 months after the reporting date which are classified as non-current assets. Loans and receivables comprise 'finance receivables', 'trade and other receivables' (excluding 'prepayments' and 'deferred transition costs'), 'cash equivalents' and 'receivables from related parties' (notes 17, 19, 20 and 30).

##### *Cash at bank*

Cash at bank comprises cash on hand and demand deposits.

##### *Trade and other receivables and finance receivables*

Trade and other receivables and finance receivables are measured on initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest rate method.

An allowance for uncollectible trade and other receivables and finance receivables is recorded based on a combination of write-off history, ageing analysis, and any specific, known troubled accounts. Receivable balances include trade debtors, finance leases and loans. Below are the methodologies the company uses to calculate its impairment reserves, which are applied consistently to its different portfolios.

The company reviews all trade and other receivables and finance receivables on a regular basis. The review consists primarily of an analysis based upon current information available about clients, such as financial statements, news reports and published credit ratings, as well as consideration of the current economic environment, collateral net of repossession costs and prior history. Additionally, portfolios are collectively assessed (excluding accounts that have been specifically reserved), based upon credit ratings, probability of default, term, asset characteristics, and loss history to determine if there is objective evidence of impairment.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### Financial instruments (continued)

Objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation.

If there is objective evidence that accounts receivable are impaired, the company calculates an impairment loss by comparing the asset's carrying amount and the present value of the expected future cash flows. Any resulting impairment loss is recognised in the income statement. The carrying amount of the impaired receivable is reduced through the use of a specific allowance account.

Losses incurred on trade and other receivables are charged against the allowance when management believes the uncollectibility of the receivable is confirmed. Subsequent recoveries, if any, are credited to the allowance.

#### *Derecognition of financial assets*

The company derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the company neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the company recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the company retains substantially all the risks and rewards of ownership of a transferred financial asset, the company continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

#### **Financial liabilities**

##### *Classification*

Financial liabilities are classified into the following specified categories: financial liabilities 'at fair value through profit or loss' (FVTPL) and financial liabilities measured at 'amortised cost'. The classification depends on the nature and purpose of the financial liabilities and is determined at the time of initial recognition.

##### *Financial liabilities at fair value through profit and loss*

Financial liabilities at fair value through profit or loss are financial liabilities held for trading. A financial liability is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges. Liabilities in this category are classified as current liabilities.



# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### Financial instruments (continued)

##### *Amortised cost*

The amortised cost of a debt instrument is calculated using the effective interest method which allocates interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition. Financial instruments held at amortised cost include 'trade and other payables' (excluding 'other payables', 'accrued expenses' and 'social security and other taxes'), and 'payables to related parties' (notes 22 and 30).

##### *Derivative financial liabilities*

A financial liability is classified as held for trading if:

- It has been acquired or incurred principally for the purpose of selling or repurchasing it in the near term; or
- On initial recognition it is part of a portfolio of identical financial instruments that the company manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

Financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognised in the income statement. Gains and losses are included in the 'cost of sales' line item in the income statement. Fair value is determined in the manner described in note 23.

##### *Trade and other payables*

Trade and other payables are recognised when the company becomes obliged to make future payments resulting from the purchase of goods or services. Amounts are unsecured and usually settled on standard commercial trade terms. Trade and other payables are initially measured at fair value.

Trade and other payables are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

##### *Derecognition of financial liabilities*

The company derecognises financial liabilities when, and only when, the company's obligations are discharged, cancelled or they expire.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 1 Accounting policies (continued)

#### Financial instruments (continued)

##### *Debt and equity instruments*

Debt and equity instruments are classified as either liabilities or as equity in accordance with the substance of the contractual arrangement.

##### *Interest and dividends*

Interest and dividends are classified as expenses or as distributions of profit consistent with the statement of financial position classification of the related debt or equity instruments or component parts of compound instruments.

#### **Provisions**

Provisions are recognised when the company has a present obligation as a result of a past event, and it is probable that the company will be required to settle that obligation. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the reporting date, and are discounted to present value where the effect is material.

Provisions for environmental remediation are recognised when the company introduces to market a product which, under European Union directives, the company is required to take back from the customer free of charge at a later date, for disposal in an environmentally friendly manner.

Provisions for vacant space and restructuring costs are recognised when the company has a detailed formal plan for the restructuring that has been communicated to affected parties.

#### **Cash and cash equivalents**

Cash and cash equivalents disclosed in the statement of cash flows comprise cash at bank and short term deposits with related parties that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

### 2 Significant accounting estimates and judgements

The application of accounting standards and policies requires the company to make estimates and assumptions about future events that directly affect its reported financial condition and operating performance. The accounting estimates and assumptions discussed are those that the company considers to be most critical to its financial statements. An accounting estimate is considered critical if both (a) the nature of estimates or assumptions are subjective and judgemental, and (b) the impact within a reasonable range of outcomes of the estimates and assumptions is material to the company's financial condition or operating performance. The directors consider the following to be subject to significant accounting estimates and assumptions.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 2 Significant accounting estimates and judgements (continued)

#### *Revenue recognition*

Application of the various accounting principles in IFRS related to the measurement and recognition of revenue requires that the company make judgements and estimates. Specifically, complex arrangements with non-standard terms and conditions may require significant contract interpretation to determine the appropriate accounting, including whether the deliverables specified in a multiple element arrangement should be treated as separate units of accounting. Other significant judgements include determining whether the company or a reseller is acting as the principal in a transaction and whether separate contracts are considered part of one arrangement.

Revenue recognition is also impacted by the company's ability to estimate sales incentives, expected returns and allowances for uncollectible receivables. The company considers various factors, including a review of specific transactions, the credit-worthiness of the customers, historical experience and market and economic conditions when calculating these provisions and allowances.

#### *Long-term contracts*

The company enters into numerous service contracts through its Global Technology Services and Global Business Services businesses. During the contractual period, revenue, cost and profits may be impacted by estimates of the ultimate profitability of each contract, particularly contracts for which the company uses the percentage of completion (POC) method of accounting. If at any time these estimates indicate the contract will be unprofitable, the entire estimated loss for the remainder of the contract is recorded immediately. The company performs ongoing profitability analysis of its services contracts in order to determine whether the latest estimates require updating. Key factors reviewed by the company to estimate the future costs to complete each contract are future labour costs, future product costs and productivity efficiencies.

#### *Impairment review*

The company reviews property, plant and equipment, intangible assets and investments in subsidiaries annually for impairment. The application of impairment accounting requires the use of significant estimates and assumptions. Impairment testing requires an estimate of future cash flows which are discounted to their present value. The company's estimates are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable. These valuations require the use of management's assumptions, which would not reflect unanticipated events and circumstances that may occur (notes 12-14).

#### *Pension assumptions*

The measurement of the company's defined benefit obligation to its employees and net periodic pension cost/income requires the use of certain assumptions, including, among others, estimates of discount rates and inflation. Changes in these assumptions may affect the future funding into the pension plan, the charge or credit to the income statement and the actuarial gain or loss recognised in the statement of comprehensive income (note 24).

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 2 Significant accounting estimates and judgements (continued)

#### *Pension litigation*

As further detailed in note 24, the High Court has acknowledged that certain changes made to the company's UK defined benefit plans were within IBM's discretion, but ruled that IBM breached its implied duty of good faith both in implementing these changes and in the manner in which it consulted with employees.

Proceedings to determine remedies were held on 21 July 2014 and, on 20 February 2015, the High Court held that for IBM to make changes to accruals under the plan would require a new consultation of the participants, but to make other changes (including to the early retirement policy) would not require such consultation.

IBM United Kingdom Limited has appealed both the breach and remedies judgements, and the hearing before the Court of Appeal took place in May 2017. The Court of Appeal has not delivered its judgment. There are a wide range of potential outcomes in this litigation, and no certainty as to outcome. If the appeal is unsuccessful, and subject to any further appeals, the Court's rulings would require IBM to reverse one or more of the changes made retroactive to their effective dates. IBM believes that it has reasonable prospects of success on appeal, and, therefore, has not made any adjustment to the financial statements.

#### *Income taxes*

During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. As a result, the company recognises tax liabilities based on estimates of whether additional taxes and interest will be due. The company believes that its accruals for tax liabilities are adequate for all open audit years based on its assessment of many factors including past experience and interpretations of tax law. This assessment relies on estimates and assumptions and may involve a series of complex judgements about future events. To the extent that new information becomes available which causes the company to change its judgement regarding the adequacy of existing tax liabilities, such changes to tax liabilities will impact income tax expense in the period in which such determination is made (note 11).

#### *Deferred tax assets*

Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future crystallisation of the underlying temporary differences can be deducted. An assessment of future profits is prepared based on current market and economic conditions, and an estimate of future market and economic conditions. Factors that could result in actual future profits being lower than estimated future profits relate to significant changes in the economy, or a significant change in the economic health of a particular client or industry segment (note 16).

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 3 Revenue

	Home £m	Export £m	Total £m
<b>2016</b>			
Hardware	117.5	-	117.5
Global Services	2,355.1	798.9	3,154.0
Software	627.7	-	627.7
	<b>3,100.3</b>	<b>798.9</b>	<b>3,899.2</b>
<b>2015</b>			
Hardware	162.9	-	162.9
Global Services	2,255.9	782.6	3,038.5
Software	456.3	-	456.3
	<b>2,875.1</b>	<b>782.6</b>	<b>3,657.7</b>

Revenue is derived from goods and services supplied from the United Kingdom. Exports are to fellow subsidiary, group undertakings and the ultimate parent company. Home revenue includes an immaterial amount generated from sales made within Gibraltar.

Hardware includes sales of servers, from supercomputers to mid range technology, and storage technology.

Global Services offers customers comprehensive IT services integrated with business insight to reduce costs, improve productivity, and gain competitive advantage. Many client contracts in the United Kingdom begin with engagement with the Global Business Services division, where consultants and industry experts provide deep industry knowledge. This division also provides Application Development and Maintenance services. The Global Technology Services unit provides a full range of IT services, including managing and operating entire information technology systems, consulting on the best use of technology infrastructure, maintaining systems, Cloud Service offerings (SaaS, IaaS, PaaS, BPaaS) and Business Continuity and Recovery Services.

Software sales include operating systems, middleware and industry specific solutions for Commerce, Cloud, Security, Analytics, Mobile and use of Social Media. IBM is helping our clients to remove the barriers that impede the flow of information within their enterprises by increasingly providing open standards-based software solutions.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 4 Expenses by nature

	2016 £m	2015 £m
Costs of services and products	2,120.3	1,804.6
Cost of licences	180.1	165.7
Employee expenses (note 7)	1,296.6	1,323.9
Depreciation of property, plant and equipment (note 12)	68.1	75.0
Amortisation of deferred transition costs	60.3	33.7
Impairment of deferred transition costs	40.0	-
(Gain) / loss on disposal of property, plant and equipment	(0.4)	0.4
Property rental costs (note 5)	34.5	33.4
Advertising costs	15.1	8.6
Net foreign currency exchange gain	(10.3)	(20.0)
Other expenses	48.5	96.2
<b>Total cost of sales and administrative expenses</b>	<b>3,852.8</b>	<b>3,521.5</b>

Costs amounting to £144.1 million (2015: £123.8 million) have been reclassified from advertising costs to costs of services and products.

### 5 Lease income / (costs)

Details of operating lease and finance lease income included in revenue in the income statement are set out below:

	2016 £m	2015 £m
<b>Lease income:</b>		
- Operating lease income	0.2	0.1
- Finance lease interest income	0.8	0.7

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 5 Lease income / (costs) (continued)

Details of operating lease costs are set out below:

	2016 £m	2015 £m
<b>Operating lease costs:</b>		
- Land and buildings	(34.5)	(33.4)
- Plant and equipment	(11.8)	(12.9)

### 6 Auditors' remuneration

	2016 £000	2015 £000
Audit services in respect of the company's financial statements	805	804
Audit related assurance services	115	108
Taxation advisory services	318	187
All other services	10	9
	<b>1,248</b>	<b>1,108</b>
 Audit services in respect of the company's associated pension scheme	 78	 81

In addition, auditors' remuneration of £122,000 (2015: £128,000) was borne by this company on behalf of fellow IBM UK group undertakings.

### 7 Employee expenses

	2016 £m	2015 £m
Wages and salaries	1,067.7	1,084.4
Social security costs	114.9	126.8
Pension cost for defined contribution pension plans	84.9	84.1
Pension cost for defined benefit pension plans (note 24)	11.3	10.5
Share based payment expense (note 25)	17.8	18.1
	<b>1,296.6</b>	<b>1,323.9</b>

Pension costs of £11.3 million (2015: £10.5 million) in respect of defined benefit pension schemes represent amounts charged to operating profit. These amounts do not include amounts credited to finance income (see note 24) and amounts recognised in the statement of comprehensive income in respect of defined benefit pension schemes.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 7 Employee expenses (continued)

The average monthly number of employees, including directors, during the year was made up as follows:

	2016 Number	2015 Number (restated)
Services and marketing	10,811	12,043
Product development	2,401	2,668
	13,212	14,711

These totals include employees who have fixed-term contracts with the company. They also include 70 employees (2015: 100 employees) whose duties were carried out mainly outside of the United Kingdom.

### 8 Directors' emoluments

The emoluments of the directors and the number of share options and share appreciation rights, in International Business Machines Corporation, exercised by the directors in respect of their services as directors or otherwise in connection with the management of the company, its parent IBM United Kingdom Holdings Limited and its parent IBM North Region Holdings, are shown in the following sections of this note. It is not practicable to perform any allocation of these total emoluments between the respective companies as such amounts are earned in respect of the directors' services to the group of companies as a whole.

The directors' aggregate emoluments in respect of qualifying services were:

	2016 £	2015 £
Aggregate emoluments	2,667,163	2,570,970
Contributions to defined contribution schemes	141,114	142,230
Share-based payments benefits	1,331,338	1,361,744

	2016 Number	2015 Number
Number of directors who exercised share options	-	1
Number of directors who received shares in respect of qualifying service under a long term incentive scheme	7	6
Number of directors who are deferred members of defined benefit schemes	4	3
Number of directors who accrued benefits under defined contribution schemes	7	6



# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 8 Directors' emoluments (continued)

One director was appointed and one resigned during the year. Four directors resigned and one director was appointed subsequent to the year end. No directors were appointed nor resigned during the prior year.

Aggregate emoluments receivable under long term incentive schemes, excluding share based payments, were £nil (2015: £nil).

Emoluments of highest paid director:

	2016 £	2015 £
Aggregate emoluments	660,590	634,467
Accrued pension at the year end in the defined benefit pension scheme	58,942	57,566
Amounts paid, or treated as paid, to a defined contribution scheme in respect of qualifying services	24,048	23,760

The highest paid director received shares in respect of qualifying services under a long term incentive scheme during 2016 and 2015. No other emoluments under long term incentive schemes were received by the highest paid director.

The highest paid director did not exercise share options during 2016 or 2015.

### 9 Other finance income

	2016 £m	2015 £m
Interest on loans to parent company	2.9	3.8
Interest on loans to group undertakings	6.0	6.4
Other interest receivable	-	0.1
	8.9	10.3

Interest on amounts owed by parent company and interest bearing amounts owed by group undertakings are charged at variable rates based on LIBOR.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 10 Other finance costs

	2016 £m	2015 £m
Finance costs from group undertakings	5.7	5.0
Other interest payable	-	0.2
	<b>5.7</b>	<b>5.2</b>

Interest on loans from group undertakings is charged at variable rates based on LIBOR.

Finance costs incurred from group undertakings include £5.3 million (2015: £5.0 million) of factoring charges.

### 11 Income tax expense

#### (a) Analysis of expense in the year

	2016 £m	2015 £m
<b>Current tax:</b>		
UK corporation tax based on profit for the year at 20.00% (2015: 20.25%)	2.9	14.4
Adjustments relating to prior years	32.2	3.0
<b>Total current tax</b>	<b>35.1</b>	<b>17.4</b>
<b>Deferred tax:</b>		
Movements on temporary differences	23.5	25.3
Adjustments relating to prior years	5.9	(1.7)
<b>Total deferred tax (note 16)</b>	<b>29.4</b>	<b>23.6</b>
<b>Income tax expense</b>	<b>64.5</b>	<b>41.0</b>

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 11 Income tax expense (continued)

#### (b) Reconciliation of tax expense

The tax assessed on the profit for the year is higher (2015: higher) than the standard rate of corporation tax in the UK of 20.00% (2015: 20.25%).

	2016 £m	2015 £m
Profit before income tax	125.7	190.8
Tax at the domestic income tax rate of 20.00% (2015: 20.25%)	25.1	38.6
Effects of:		
Adjustments relating to prior years	38.1	1.3
Expenses not deductible for tax purposes	14.0	12.3
Income not subject to UK tax	(11.0)	(7.8)
Research and development tax credits	-	(5.6)
Share option (credit) / charge	(1.4)	0.7
Withholding tax	1.3	1.8
Movement in unrecognised deferred tax	(0.2)	(0.3)
Adjustment to tax rates	(1.4)	-
<b>Total income tax expense (note 11(a))</b>	<b>64.5</b>	<b>41.0</b>

In June 2017 the company agreed the closure of certain ongoing tax audits with Her Majesty's Revenue and Customs ('HMRC'). This has resulted in a net prior year charge for income taxes of £36.4 million in respect of additional taxes due.

#### (c) Factors that may affect future tax expense

Finance Act (No. 2) 2015 included legislation to reduce the main rate of corporation tax from 20% to 19% with effect from 1 April 2017. Finance Act 2016 included legislation to further reduce the rate to 17% with effect from 1 April 2020. The impact of these changes is reflected in any closing deferred tax balances.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 12 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Fixtures and fittings £m	Total £m
<b>Cost</b>				
At 1 January 2015	101.3	457.9	271.1	830.3
Additions	1.3	76.8	17.0	95.1
Disposals	-	(92.2)	(9.7)	(101.9)
<b>At 31 December 2015</b>	<b>102.6</b>	<b>442.5</b>	<b>278.4</b>	<b>823.5</b>
Additions	6.5	60.6	19.1	86.2
Disposals	-	(81.6)	(6.8)	(88.4)
<b>At 31 December 2016</b>	<b>109.1</b>	<b>421.5</b>	<b>290.7</b>	<b>821.3</b>
<b>Accumulated depreciation</b>				
At 1 January 2015	73.9	342.3	183.3	599.5
Charge for year	2.2	55.0	17.8	75.0
Disposals	-	(88.5)	(9.3)	(97.8)
<b>At 31 December 2015</b>	<b>76.1</b>	<b>308.8</b>	<b>191.8</b>	<b>576.7</b>
Charge for year	2.2	52.0	13.9	68.1
Disposals	-	(56.9)	(4.3)	(61.2)
<b>At 31 December 2016</b>	<b>78.3</b>	<b>303.9</b>	<b>201.4</b>	<b>583.6</b>
<b>Net book value</b>				
<b>At 31 December 2016</b>	<b>30.8</b>	<b>117.6</b>	<b>89.3</b>	<b>237.7</b>
<b>At 31 December 2015</b>	<b>26.5</b>	<b>133.7</b>	<b>86.6</b>	<b>246.8</b>

The net book value of land and buildings relates entirely to freehold assets.

Plant and equipment includes assets rented to lessees under operating leases. The capital value of these assets is nil (2015: £4.1 million) and the accumulated depreciation is nil (2015: £4.1 million).

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 13 Intangible assets

	Goodwill £m	Other intangible assets £m	Total £m
<b>Cost</b>			
At 1 January 2015	593.1	0.7	593.8
<b>At 31 December 2015</b>	<b>593.1</b>	<b>0.7</b>	<b>593.8</b>
Transfers from investments (note 14)	30.0	-	30.0
<b>At 31 December 2016</b>	<b>623.1</b>	<b>0.7</b>	<b>623.8</b>
<b>Accumulated amortisation and impairment</b>			
At 1 January 2015	(310.9)	(0.7)	(311.6)
<b>At 31 December 2015</b>	<b>(310.9)</b>	<b>(0.7)</b>	<b>(311.6)</b>
<b>At 31 December 2016</b>	<b>(310.9)</b>	<b>(0.7)</b>	<b>(311.6)</b>
<b>Net book value</b>			
<b>At 31 December 2016</b>	<b>312.2</b>	<b>-</b>	<b>312.2</b>
At 31 December 2015	282.2	-	282.2

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 13 Intangible assets (continued)

#### Impairment

The directors conducted an impairment review of the intangible assets held by the company in accordance with IAS 36. No impairment charge has been recognised as a result of this review.

It is not possible to track the cash flows of each constituent of goodwill hence management have deemed there to be one cash generating unit, and have therefore assessed the carrying value of goodwill, together with the carrying value of investments, for impairment based on the company's cash flow model.

The recoverable amount of goodwill was determined based on value in use calculations. These calculations used pre-tax cash flow projections based on financial budgets approved by management covering a five year period and are denominated in British Pound sterling. Cash flows beyond the five year period are extrapolated using estimated growth rates. The growth rate of 2.5% (2015: 3.0%) used is in line with the long term average growth rate for the industry in which the group operates. The pre-tax discount rate used in this calculation was 11.6% (2015: 11.8%). If the discount rate used for impairment review increased by 1% to 12.6% there would still be no impairment. A 1% decrease in the growth rate to 1.5% would also not cause any impairment.

The key assumptions used in the impairment testing were a) discount rates and b) rates of growth.

#### a) Discount rate

The discount rate reflects management's estimate of the pre-tax cost of capital employed in the current market and the risks specific to the information technology industry.

#### b) Rates of growth

Management have reviewed industry forecasts and consider the rate of 2.5% to be reasonable for the purposes of the impairment test.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 14 Investments in subsidiaries

	£m
<b>Cost</b>	
At 1 January 2015	500.9
Liquidations	(31.6)
Disposals	(12.7)
<b>At 31 December 2015</b>	<b>456.6</b>
Additions	34.2
Liquidations	(47.4)
Transfers to goodwill	(30.0)
<b>At 31 December 2016</b>	<b>413.4</b>
<b>Impairment</b>	
At 1 January 2015	(11.8)
Disposals	5.2
<b>At 31 December 2015</b>	<b>(6.6)</b>
<b>At 31 December 2016</b>	<b>(6.6)</b>
<b>Net book value</b>	
<b>At 31 December 2016</b>	<b>406.8</b>
At 31 December 2015	450.0

During the year the company made the following acquisitions:

On 26 February 2016 the company acquired 100% of the share capital of Silverpop Systems Limited for £24.4 million. Goodwill of £22.5 million arose on transfer of the trade and assets to the company.

On 18 March 2016 the company acquired 100% of the share capital of Optevia Limited for £6.7 million. Goodwill of £4.6 million arose on transfer of the trade and assets to the company.

On 29 June 2016 the company acquired 100% of the share capital of Cleversafe UK Limited for £3.0 million. Goodwill of £2.9 million arose on transfer of the trade and assets to the company.

On 30 December 2016 the company acquired 100% of the share capital of Resilient Systems Europe Limited for £0.1 million. Goodwill of £nil arose on transfer of the trade and assets to the company.

During the year the company acquired 100% of the share capital of two dormant companies: Cascade Hosting and Applications Services UK Limited; and EZLegacy UK Limited for £1 each

During the prior year the company did not make any acquisitions.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 14 Investments in subsidiaries (continued)

To support its continued operations in the UK, IBM has continued to purchase investments during 2017.

The company had beneficial ownership of all the ordinary share capital and voting rights of the following companies at 31 December 2016 and 2015 (unless otherwise stated).

Name of subsidiary	Country of incorporation	Holding	Nature of business
<b>Direct holdings</b>			
Cleversafe UK Limited	Great Britain	100%	Trading
Optevia Limited	Great Britain	100%	Trading
Silverpop Systems Limited	Great Britain	100%	Trading
Resilient Systems Europe Limited	Great Britain	100%	Trading
Algorithmics Risk Management Limited	Great Britain	100%	Non-trading
Ashbourne Assessment Systems Limited *	Great Britain	100%	Non-trading
Cascade Hosting and Applications Services UK Limited	Great Britain	100%	Non-trading
i2 Holdings Limited	Great Britain	100%	Non-trading
i2 Intermediate Holdings Limited	Great Britain	100%	Non-trading
Kenexa Quorum Holdings Limited	Great Britain	100%	Non-trading
Aspera UK Limited *	Great Britain	100%	Dormant
Cloudant Limited *	Great Britain	100%	Dormant
Daeja Image Systems Limited *	Great Britain	100%	Dormant
EZLegacy UK Limited	Great Britain	100%	Dormant
Integral Solutions Limited	Great Britain	100%	Dormant
i2 Limited	Great Britain	100%	Dormant
Kenexa Compensation UK Limited *	Great Britain	100%	Dormant
Kenexa Limited *	Great Britain	100%	Dormant
M H (UK) Limited	Great Britain	100%	Dormant
Outstart (EMEA) Limited *	Great Britain	100%	Dormant
SPSS Limited	Great Britain	100%	Dormant
Sterling Commerce (UK) Limited	Great Britain	100%	Dormant
Transitive Corporation Limited	Great Britain	100%	Dormant



# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 14 Investments in subsidiaries (continued)

Name of subsidiary	Country of incorporation	Holding	Nature of business
<b>Indirect holdings through Algorithmics Risk Management Limited</b>			
Algorithmics (UK) Limited	Great Britain	100% (indirect)	Non-trading
<b>Indirect holdings through Algorithmics (UK) Limited</b>			
Algorithmics (Beijing) Risk Management Consultancy Company Limited (China)	China	100% (indirect)	Dormant
<b>Indirect holdings through Kenexa Quorum Holdings Limited</b>			
Kenexa Global Recruitment Services Limited	Great Britain	100% (indirect)	Dormant
<b>Indirect holdings through Transitive Corporation Limited</b>			
Transitive Limited	Great Britain	100% (indirect)	Dormant

\* Denotes companies that entered liquidation during the year.

The registered address for all the above subsidiary undertakings is PO BOX 41 North Harbour, Portsmouth, Hampshire, United Kingdom, PO6 3AU.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 14 Investments in subsidiaries (continued)

During the year Ashbourne Assessment Systems Limited, Aspera UK Limited, Cloudant Limited, Daeja Image Systems Limited, Kenexa Limited, Kenexa Compensation UK Limited and Outstart (EMEA) Limited went into liquidation. The amounts written off investments represents the net book value of investment cost less the recovered share capital. The write off charged to administrative expenses in the income statement is £47.4 million (2015: loss charged £31.6 million).

Dividends received in the income statement of £46.4 million were from the following companies: Ashbourne Assessment Systems Limited (£0.3 million), Daeja Image Systems Limited (£2.7 million), Kenexa Limited (£36.0 million), Kenexa Compensation UK Limited (£4.5 million) and Outstart (EMEA) Limited (£2.9 million). Dividends received in the prior year totalled £38.5 million.

During the year the directors conducted an impairment review of the investments held and consider all investments to be supported by their underlying net assets.

### 15 Purchase of business

During the year the company acquired the trade and associated assets and liabilities of subsidiary undertakings: Cleversafe UK Limited, Optevia Limited and Silverpop Systems Limited for a consideration of £4.1 million. The transfers of assets and liabilities were at net book value. All of the transfers were completed through a non-interest bearing related party payable.

The impact of this is set out in the table below:

	£m
Property, plant and equipment	-
Trade and other receivables due within one year	6.0
Cash	1.8
Trade and other payables due within one year	(3.3)
Deferred tax	-
Corporation tax	(0.4)
<b>Total net assets acquired at book value</b>	<b>4.1</b>

Included within trade and other receivables due within one year is £0.8 million of amounts held on short term deposit.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 16 Deferred tax assets / (liabilities)

#### Movement in the deferred tax asset / (liability)

	Fixed asset temporary differences £m	Short term temporary differences £m	Retirement benefit £m	Total £m
At 1 January 2015	79.7	33.2	(45.0)	67.9
(Charged) / credited to the income statement	(8.3)	1.1	(16.4)	(23.6)
Credited to statement of comprehensive income	-	-	6.4	6.4
Debited to reserves in respect of share options	-	(0.9)	-	(0.9)
<b>At 31 December 2015</b>	<b>71.4</b>	<b>33.4</b>	<b>(55.0)</b>	<b>49.8</b>
Charged to the income statement	(15.9)	(9.5)	(4.0)	(29.4)
Charged to statement of comprehensive income	-	-	(76.5)	(76.5)
<b>At 31 December 2016</b>	<b>55.5</b>	<b>23.9</b>	<b>(135.5)</b>	<b>(56.1)</b>

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 16 Deferred tax assets / (liabilities) (continued)

Movement in the unrecognised deferred tax asset:

	Total £m
At 1 January 2015	1.1
Movement in unrecognised amounts in the year	(0.3)
<b>At 31 December 2015</b>	<b>0.8</b>
Movement in unrecognised amounts in the year	(0.2)
<b>At 31 December 2016</b>	<b>0.6</b>

The company has £0.6 million (2015: £0.8 million) of potential deferred tax assets in respect of trading balances from acquired companies, which has not been recognised on the grounds that this is not considered recoverable in the foreseeable future. There is no unrecognised deferred tax in respect of the retirement benefit scheme.

The recognition of deferred tax assets is determined by reference to the company's estimate of recoverability based on models to forecast future taxable profits.

### 17 Finance receivables

	2016 £m	2015 £m
<b>Non-current</b>		
Finance lease receivables	0.1	0.2
Customer loans	11.4	5.4
	<b>11.5</b>	<b>5.6</b>
<b>Current</b>		
Finance lease receivables	0.1	0.1
Customer loans	12.5	6.6
	<b>12.6</b>	<b>6.7</b>

Finance lease receivables are for leases that relate principally to the company's equipment and are generally for terms ranging from two to seven years. Customer loan receivables are provided by the company to clients to finance the purchase of IBM's software and services.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 17 Finance receivables (continued)

Finance lease and customer loan receivables include invoiced amounts not paid at the end of the year. The average contractual credit period on invoiced amounts is 30 days. Unless specifically negotiated, interest is charged at 8% above base rate per annum, in line with the Late Payment of Commercial Debts (Interest) Act 1998, on the outstanding balance. The company has fully provided for all invoiced amounts aged over 365 days.

Before entering into a finance lease arrangement, the company undertakes a credit assessment on the proposed transaction, either through the IBM Credit Team or, for certain transactions of a lower size, a credit scoring system based on external credit agency information, to assess the customer's credit quality and define credit limits by customer. Credit limits for most customers are valid for no more than six months, and are reviewed if required to be extended. The balances on leases for hardware are usually secured over the leased equipment and the fair value of the collateral held by the company is £0.1 million (2015: £0.2 million).

As of 31 December 2016, finance lease and customer loan receivables of £nil (2015: £nil) were past due but not impaired. These relate to a number of customers for whom there is no recent history of default. The ageing analysis of these receivables is as follows:

	2016 £m	2015 £m
Up to 3 months	-	-

In determining the recoverability of the finance lease and customer loan receivables, the company considers any change in the credit quality of the receivables balance from the date credit was initially granted up to the reporting date. The concentration of credit risk is limited due to the customer base being large and diverse. Accordingly, the directors believe that there is no credit provision required.

Amounts due from lessees under finance leases are recognised as receivables at the amount of the company's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the company's net investment outstanding in respect of the leases.

#### Amounts receivable under finance leases:

	Minimum lease payments		Present value of minimum lease payments	
	2016 £m	2015 £m	2016 £m	2015 £m
Not later than one year	0.1	0.1	0.1	0.1
Later than one year and not later than five years	0.1	0.2	0.1	0.2
	0.2	0.3	0.2	0.3
Less:				
Unearned finance income	-	-	-	-
	0.2	0.3	0.2	0.3

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 17 Finance receivables (continued)

The interest rate inherent in the leases is fixed at the contract date for the entire lease term. The average effective interest contracted is approximately 3.65% (2015: 4.02%) per annum.

Assets with an unguaranteed residual value totalled £nil (2015: £nil).

Assets purchased by the company for supply to customers under finance leases totalled £nil in the year (2015: £nil).

### 18 Inventories

	2016 £m	2015 £m
Finished goods and goods for resale	12.5	1.5

Finished goods and goods for resale includes an allowance for obsolescence of £nil (2015: £0.1 million).

The cost of inventories recognised as an expense and included in 'cost of sales' amounted to £848.9 million (2015: £823.9 million).

### 19 Trade and other receivables

	2016 £m	2015 £m
<b>Non-current</b>		
Prepayments	14.9	15.4
Deferred transition costs	107.7	113.9
	122.6	129.3
<b>Current</b>		
Trade receivables (i)	27.9	47.6
Less: provision for impairment of trade receivables (ii)	(0.4)	(0.2)
Amounts recoverable on contracts	57.4	76.7
Other receivables	19.4	15.5
Prepayments	73.3	75.7
Deferred transition costs	37.4	33.6
Accrued income	136.2	90.6
	351.2	339.5

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 19 Trade and other receivables (continued)

IBM United Kingdom Limited has entered into an agreement under which it sells for cash certain of its trade receivables to IBM United Kingdom Financial Services Limited ("the factor"), a group undertaking, based in the United Kingdom, of IBM. The terms of the agreement preclude the repurchase of any trade receivables which have been sold to the factor. Any losses incurred in the collection of the debt sold under this agreement are not borne by the company. These trade receivables totalling £212.8 million (2015: £193.7 million) have been excluded from the statement of financial position in accordance with IAS 39 "Financial Instruments: Recognition and Measurement".

(i) The majority of customers are on immediate payment terms. No interest is charged on the trade receivables for the first 30 days from the date of the invoice. Thereafter, interest is charged at 8% above base rate per annum, in line with the Late Payment of Commercial Debts (Interest) Act 1998, on the outstanding balance. The company has provided fully for all receivables over 365 days old. Trade receivables between 30 and 365 days old are provided for based on estimated irrecoverable amounts from the sale of goods, determined by reference to past default experience.

Before accepting any new customer, the company uses an external credit scoring system to assess the potential customer's credit quality and define credit limits by customer. Limits and scoring attributed to customers are reviewed annually.

Included in the company's trade receivable balance are receivables with a carrying amount of £53.2 million (2015: £45.8 million) which are past due at the reporting date for which the company has not provided as there has not been a significant change in credit quality and the company believes that the amounts are still considered fully recoverable. The company does not hold any collateral over these balances. The average past due age of these receivables is 7 days (2015: 11 days).

Ageing of past due but not impaired, as calculated from the last day of the month in which the invoice is raised:

	2016 £m	2015 £m
Up to 3 months	51.9	44.6
3 to 6 months	1.1	0.8
Over 6 months	0.2	0.4
	53.2	45.8

(ii) Movement for the provision for impairment of trade receivables:

	2016 £m	2015 £m
Balance at the beginning of the year	(0.2)	(0.2)
Impairment losses recognised on receivables	(0.3)	(0.3)
Amounts written off during the year	-	(0.4)
Unused amounts reversed	0.1	0.7
Balance at the end of the year	(0.4)	(0.2)

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 19 Trade and other receivables (continued)

In determining the recoverability of the trade receivables, the company considers any change in the credit quality of the trade receivables from the date credit was initially granted up to the reporting date. The concentration of credit risk is limited due to the customer base being large and diverse. Accordingly, the directors believe that there is no further credit provision required in excess of the provision for impairment of trade receivables.

Ageing of impaired trade receivables:

	2016 £m	2015 £m
Over 6 months	(0.4)	(0.2)
	(0.4)	(0.2)

### 20 Cash and cash equivalents

	2016 £m	2015 £m
Cash at bank	6.8	9.8

Cash at bank is held at financial institutions with short-term credit ratings of P-2 (Moody's Investors). For the purposes of the statement of cash flows, cash and cash equivalents comprise the following:

	2016 £m	2015 £m
Cash at bank	6.8	9.8
Short term deposits with related parties (note 30)	467.0	1,915.8
	473.8	1,925.6

### 21 Provisions for liabilities and charges

	2016 £m	2015 £m
<b>Non-current</b>		
Restructuring provision	2.8	8.3
Asset retirement obligation	4.6	6.0
	7.4	14.3
<b>Current</b>		
Restructuring provision	9.2	6.2
Asset retirement obligation	4.0	3.7
	13.2	9.9



# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 21 Provisions for liabilities and charges (continued)

The restructuring provision relates both to the consolidation of the company's property portfolio and to workforce restructuring. These provisions are expected to be utilised over the next three years. The property element of the provision recognised is based on the excess of the estimated cash flows to meet the unavoidable cost under the rental contract over the estimated cash flows to be received from sub-leasing. The estimated cash flows are discounted using a market determined risk adjusted rate.

The asset retirement provision is a legal or constructive obligation associated with dismantling, removing and restoring items of property held under an operating lease. A provision is recognised and measured, both initially and subsequently, at the estimated expenditure required to settle the present obligation at the reporting date discounted at a current market-based discount rate. The provision is reviewed at each reporting date and adjusted to reflect the current best estimate. When the effect of a change in estimated outflows of resources embodying economic benefits and/or the discount rate is material, that change is recognised and the related asset retirement costs are capitalised by increasing the carrying amount of the related asset by the same amount as the liability. Capitalised asset retirement costs are subsequently depreciated over the shorter of the lease term of the related property or the useful life of the related asset.

	Restructuring provision £m	Asset retirement obligation £m	Total £m
At 1 January 2015	53.0	10.8	63.8
Charged to the income statement	31.1	0.6	31.7
Utilised during the year	(67.7)	(1.2)	(68.9)
Unwinding of discount	-	0.2	0.2
Released to the income statement	(1.9)	(0.7)	(2.6)
<b>At 31 December 2015</b>	<b>14.5</b>	<b>9.7</b>	<b>24.2</b>
Charged to the income statement	13.5	-	13.5
Utilised during the year	(15.5)	(0.3)	(15.8)
Unwinding of discount	0.1	-	0.1
Released to the income statement	(0.6)	(0.8)	(1.4)
<b>At 31 December 2016</b>	<b>12.0</b>	<b>8.6</b>	<b>20.6</b>

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 22 Trade and other payables

	2016 £m	2015 £m
<b>Non-current</b>		
Other payables	11.2	10.4
<b>Current</b>		
Payable to trade suppliers	131.2	140.4
Accrued expenses	151.9	165.7
Social security and other taxes	122.8	146.2
	405.9	452.3

### 23 Financial instruments

#### Financial risk management

The company is exposed to a variety of financial risks as a result of its operations that include the effects of changes in liquidity and interest rate risk, credit risk, market prices, and foreign exchange risk. The company has a strong risk management programme in place aligned to the worldwide programme of the company's ultimate parent company, International Business Machines Corporation.

#### Capital risk management

The company manages its capital to ensure that the company will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance. The company's overall capital management strategy remains unchanged from the prior year and is controlled globally. The capital structure of the company consists of debt to related parties disclosed in note 30, and equity attributable to equity holders of the parent, comprising issued capital, share premium and retained earnings as disclosed in the statement of changes in equity.

The company has no externally imposed capital requirements to which it is subject.

#### Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement, and the basis on which income and expenses are recognised in respect of each class of financial asset, financial liability, and equity instrument are disclosed in note 1 to the financial statements.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 23 Financial instruments (continued)

#### Categories of financial instruments

	2016 Loans and receivables £m	2016 Amortised cost £m	2016 FVTPL £m
<b>Financial assets</b>			
Finance receivables	24.1	-	-
Trade and other receivables	240.5	-	-
Receivables from related parties	2,642.3	-	-
Derivatives from related parties	-	-	21.2
Cash at bank	6.8	-	-
	<b>2,913.7</b>	<b>-</b>	<b>21.2</b>
<b>Financial liabilities</b>			
Trade and other payables	-	(131.2)	-
Payables to related parties	-	(932.2)	-
	<b>-</b>	<b>(1,063.4)</b>	<b>-</b>

	2015 Loans and receivables £m	2015 Amortised cost £m	2015 FVTPL £m
<b>Financial assets</b>			
Finance receivables	12.3	-	-
Trade and other receivables	230.2	-	-
Receivables from related parties	2,682.2	-	-
Derivatives from related parties	-	-	9.0
Cash at bank	9.8	-	-
	<b>2,934.5</b>	<b>-</b>	<b>9.0</b>
<b>Financial liabilities</b>			
Trade and other payables	-	(140.4)	-
Payables to related parties	-	(912.9)	-
	<b>-</b>	<b>(1,053.3)</b>	<b>-</b>

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 23 Financial instruments (continued)

#### Financial risk management objectives

IBM's corporate treasury function provides funding and risk management services to the UK group of companies. Risk management services are provided through the monitoring and management of financial risks relating to the operations of the company through internal risk reports addressing market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk, and cash flow interest rate risk.

#### Price risk

The financial risk posed by external vendors is managed and controlled by IBM's central procurement function. Procurement is the only business unit in IBM which is authorised to make financial commitments to external vendors. The unit has responsibility for achieving overall value for IBM in terms of supplier selection at the optimum price. All procurement activities are carried out under worldwide IBM guidelines. The financial risk posed by sales price is managed through a central pricing team. The business only agrees to sign contracts once the appropriate pricing approval has been obtained.

#### Foreign currency risk

The company undertakes certain transactions denominated in foreign currencies, hence exposures to exchange rate fluctuations arise. Foreign currency forward contracts are entered into with a third party bank by the IBM International Treasury Services Company ('the Treasury Centre') which in turn passes down the impacts of these derivatives by entering into matching intercompany derivatives with the company. The company does not apply hedge accounting for these derivatives. Additionally, when loans and leases are supplied in a foreign currency, the company borrows from the Treasury Centre in the same foreign currency to fund the transaction, therefore hedging against foreign exchange risk.

#### Foreign currency sensitivity

The company's foreign exchange rate risk results from the revaluation of its US dollar and Euro denominated transactions and balances with group undertakings and third party customers and suppliers. A 1 percent fluctuation is the rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates.

At 31 December 2016, if British Pounds Sterling weakened/strengthened against the US dollar by 1 percent, with all other variables held constant, pre-tax profit for the year would have been £0.7 million (2015: £0.8 million) lower/higher, arising principally on the foreign exchange translation of the related party payables at the reporting date.

At 31 December 2016, if British Pounds Sterling weakened/strengthened against the Euro exchange rate, with all other variables held constant, pre-tax profit for the year would have been £1.1 million (2015: £1.4 million) lower/higher, arising principally on the foreign exchange translation of the related party payables at the reporting date.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 23 Financial instruments (continued)

#### Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the company. The company has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral, where appropriate, as a means of mitigating the risk of financial loss from defaults. The company carries out credit checks on potential customers before contracts are entered into. This information is supplied by independent rating agencies where available and, if not available, the company uses other publicly available financial information and its own trading records to rate the major customers. Credit exposure is controlled by counterparty limits that are reviewed and approved by the risk management team annually.

Trade receivables consist of a large number of customers, spread across diverse industries and geographical areas. Ongoing credit evaluation is performed on the financial condition of accounts receivable.

Cash balances are held with the Treasury Centre and with NatWest Bank, which the directors assess as having high credit ratings.

The company does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The company defines counterparties as having similar characteristics if they are related entities. Concentration of credit risk did not exceed 5 percent of gross monetary assets at any time during the year.

The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the company's maximum exposure to credit risk without taking account of the value of any collateral obtained.

The company has assessed the impact of credit valuation adjustments on the related party derivatives. As the contracts are short term in nature and the exposure is with a related party, it was determined that credit adjustments would have no impact on the valuation of these derivative contracts.

The company has entered into various guarantee contracts including guaranteeing both subsidiary and group undertakings' liabilities. No liability is recorded in the statement of financial position at the reporting date as there have been no events which would trigger a material obligation under the guarantee. The maximum credit risk associated with these guarantees is not quantifiable due to the wide range of possible trigger events and hence the number of variables that exist.

#### Interest rate risk management

The company is funded internally by the Treasury Centre. As the company invests or borrows cash balances internally, it operates in either a receivable or payable position. Interest is paid or earned on the daily balance using the variable one month interest rate as the base.

Interest rate risk is managed at an IBM group level on a consolidated basis. The company's exposures to interest rates on financial assets and financial liabilities are detailed in the liquidity risk management section of this note.

# **IBM United Kingdom Limited**

## **Notes to the Financial Statements**

**For the Year Ended 31 December 2016**

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### **23 Financial instruments (continued)**

#### **Interest rate sensitivity**

The sensitivity analyses below have been determined based on the exposure to interest rates for non-derivative financial instruments at the reporting date. For variable rate liabilities, the analysis is prepared assuming the amount of liability outstanding at the reporting year end date was outstanding for the whole year. A 1 percent increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

At the reporting date, if interest rates had been 1 percent higher/lower and all other variables were held constant, the company's net profit would decrease/increase by £24.5 million (2015: decrease/increase by £26.5 million). This is mainly attributable to the company's exposure to interest rates on its variable rate borrowings and cash deposits.

#### **Liquidity risk management**

The company is funded internally by the Treasury Centre. The company manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities through its agreements with the Treasury Centre. The Treasury Centre is ultimately funded by International Business Machines Corporation. Currently the company has a net cash position (see note 20) and loans this cash to the Treasury Centre. Given the cash position, liquidity risk is minimal.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 23 Financial instruments (continued)

#### Liquidity and interest risk tables

The following table details the company's remaining contractual maturity for its financial liabilities. The tables below have been drawn up based on the undiscounted contractual cash flows of the financial liabilities including both interest and principal cash flows. The contractual maturity is based on the earliest date on which the company may be required to pay.

	Weighted average effective interest rate %	Less than 1 year £m	1 - 5 years £m	+ 5 years £m	Total £m
<b>2016</b>					
<b>Non-interest bearing:</b>					
Trade and other payables	-	131.2	-	-	131.2
Payable to related parties	-	921.3	-	-	921.3
	-	1,052.5	-	-	1,052.5
<b>Interest bearing:</b>					
Payable to related parties	3.70	10.9	-	-	10.9
	3.70	10.9	-	-	10.9
<b>2015</b>					
<b>Non-interest bearing:</b>					
Trade and other payables	-	140.4	-	-	140.4
Payable to related parties	-	912.9	-	-	912.9
	-	1,053.3	-	-	1,053.3

Amounts payable to related parties are unsecured and, where applicable, have a variable interest rate based on LIBOR.

The following table details the company's expected maturity of its financial assets. The table below has been drawn up based on the undiscounted cash flows of the financial assets including interest that will be earned on those assets. The inclusion of information on financial assets is necessary in order to understand the company's liquidity risk management as the liquidity is managed on a net asset and liability basis.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 23 Financial instruments (continued)

	Weighted average effective interest rate %	Less than 1 year £m	1 - 5 years £m	+ 5 years £m	Total £m
<b>2016</b>					
<b>Non-interest bearing:</b>					
Trade and other receivables	-	240.5	-	-	240.5
Receivables from related parties	-	199.3	-	-	199.3
Derivatives from related parties	-	21.2	-	-	21.2
	-	461.0	-	-	461.0
<b>Interest bearing:</b>					
Receivables from related parties	0.28	1,043.0	1,400.0	-	2,443.0
Cash at bank	-	6.8	-	-	6.8
Finance lease receivables	3.65	0.1	0.1	-	0.2
Customer loans	4.29	13.5	11.9	-	25.4
	-	1,063.4	1,412.0	-	2,475.4
<b>2015</b>					
<b>Non-interest bearing:</b>					
Trade and other receivables	-	230.2	-	-	230.2
Receivables from related parties	-	193.2	-	-	193.2
Derivatives from related parties	-	9.0	-	-	9.0
	-	432.4	-	-	432.4
<b>Interest bearing:</b>					
Receivables from related parties	0.36	2,489.0	-	-	2,489.0
Cash at bank	-	9.8	-	-	9.8
Finance lease receivables	4.02	0.1	0.2	-	0.3
Customer loans	4.01	7.0	5.6	-	12.6
	-	2,505.9	5.8	-	2,511.7

Amounts receivable from related parties are unsecured and, where applicable, have a variable interest rate based on LIBOR.



# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 23 Financial instruments (continued)

#### Fair value of financial instruments

The directors have carried out a review of the fair values of the financial assets and liabilities. The directors consider that the carrying values of financial assets and financial liabilities in the financial statements, except as detailed in the following table, approximate their fair values. The impact of discounting is not significant as the majority are short term and variable rated.

	Carrying amount £m	Fair value £m
<b>2016</b>		
<b>Non-current financial assets</b>		
Finance lease receivables	0.1	0.1
Customer loans	11.4	12.1
<b>2015</b>		
<b>Non-current financial assets</b>		
Finance lease receivables	0.2	0.2
Customer loans	5.4	5.8

The fair value of the financial assets above is determined in accordance with level 2 fair value measurements with pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes or similar instruments.

For financial instruments that are subsequently measured at fair value, the fair value measurement is grouped into Levels 1 to 3 based on the following fair value hierarchy:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1, that are observable for the asset or liability, either directly (i.e. as price) or indirectly (i.e. derived from prices);
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 23 Financial instruments (continued)

The following table presents the company's assets and liabilities that are measured at fair value at 31 December 2016 and 31 December 2015:

	2016 Level 2 £m	2015 Level 2 £m
<b>Financial assets</b>		
Derivatives from related parties	21.2	9.0

There are no financial instruments measured at fair value level 1 or level 3.

The fair value of the derivative from related parties is derived as the unrecognised foreign currency gains or losses relating to hedged foreign currency financial assets and liabilities.

#### Derivative gain and loss recognised in the income statement

The amount recognised in the income statement in the year in respect of foreign currency forward exchange contracts was a gain of £43.9 million (2015: gain of £12.8 million).

### 24 Retirement benefits

	2016 £m	2015 £m
<b>Statement of financial position asset for</b>		
Defined benefits plan	797.7	279.6
<b>Income statement charge for:</b>		
Defined benefits plan	4.8	7.4
<b>Remeasurement gains / (losses) recognised in the statement of other comprehensive income</b>		
Defined benefits plan	439.3	(33.0)
<b>Cumulative actuarial losses recognised in the statement of other comprehensive income</b>	(115.5)	(554.8)

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 24 Retirement benefits (continued)

#### Description of the pension plans

The IBM contributory pension plans, the IBM Pension Plan ('Main Plan') and the IBM IT Solutions Pension Scheme ('I Plan'), are administered separately from the company. The primary purpose of the plans is to provide retirement benefits to eligible employees after retirement and until death in respect of their service as employees. The assets of these plans, which comprise both defined benefit and defined contribution sections, are held in trust funds. The cost of the defined benefit sections of the plans is assessed in accordance with the advice provided by independent qualified actuaries. The defined benefit section of the Main Plan was closed to new members in April 1997. Employees who joined the company between April 1997 and April 2011 were eligible to become members of the defined contribution section of the Main plan. From April 2011 employees who join the company are eligible to become members of a group personal pension plan administered by Standard Life. The defined benefit sections were closed to future accrual from April 2011 with the exception of a sub-section of the population within the I Plan. An additional pension plan ('Prudential Platinum Plan') administers the pensions of employees transferring to IBM under a specific outsourcing contract. This is a defined benefit pension plan administered by Prudential on behalf of the company.

#### Regulatory framework

Actuarial valuations of the defined benefit sections of the pension plans are carried out every three years. The most recent valuations of the Main Plan and I Plan as at 31 December 2015 were carried out by an independent qualified actuary in October 2016 using the projected unit credit method. The actuarial valuation of the defined benefit sections of these plans as at this date showed a funding deficit of £392.0 million.

The Trustees of the Main and I Plans have agreed with the Company a schedule of contributions for each of the plans that sets out the amount of the Company's annual contributions from October 2016 to 20 October 2021 for the Main Plan and from October 2016 to 30 June 2022 for the I Plan, following the formal valuation of the plans at 31 December 2015. Under the agreed schedules the company is making deficit contributions of £23.0 million per year from 1 April 2017 to the defined benefit section of the Main Plan, and at a rate of the higher of 49% of pensionable earnings and £3.9 million, for the sub-section of the I Plan population for which accrued benefits are continuing to accrue, plus deficit contributions of £30.0 million per year from 1 January 2017 to the I Plan. Since March 2016, the company has the option to transfer Treasury Bills issued by the United States Government on a quarterly basis in lieu of cash contributions.

The Trustees and International Business Machines Corporation have signed a deed whereby International Business Machines Corporation has agreed to pay or procure payment of contributions shown in the schedules in the event that the company fails to do so. This deed expired on 31 March 2017.

A qualified independent actuary carries out an IAS 19 "Retirement Benefits" review of the Main and I Plans for the financial statements. At 31 December 2016 the IAS 19 valuation for these plans showed an asset of £789.3 million (2015: asset £270.2 million), while the tri-annual funding actuarial valuation at 31 December 2015 showed a deficit of £392.0 million. The reasons for the difference between the two valuations is driven by the assumptions used. The tri-annual funding valuation was completed in October 2016. The technical provisions adopted in the tri-annual funding valuation include a 50 basis point margin from the return on investment to discount rate for prudence. The IAS 19 valuation was carried out using the conditions which existed at 31 December 2016, and as such does not include the assumptions incorporated into the funding valuation at 31 December 2015.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 24 Retirement benefits (continued)

The main assumptions used for the funding valuation as at 31 December 2015 were as follows:

		Main Plan %	I Plan %
Initial discount rate:	WTW nominal gilt yield curve plus	0.85	1.36
Long-term discount rate:	WTW nominal gilt yield curve plus	0.52	0.52
Consumer price inflation (CPI):	RPI minus	1.00	1.00
Pensionable earnings increase:	RPI plus	0.75	0.75
Pension increases in payment:			
- RPI maximum 5%	RPI minus	0.20	0.20
- RPI maximum 2.5%	RPI minus	1.00	n/a
- CPI maximum 5%:	RPI minus	1.00	n/a
- CPI maximum 2.5%:	CPI minus	0.30	n/a

WTW: Willis Towers Watson - scheme actuaries

RPI: Retail Price Inflation - Willis Towers Watson gilt breakeven inflation curve

Due to the size of the Prudential Platinum Plan, detailed disclosure has not been made. The present value of the Prudential Platinum Plan defined benefit obligation amounts to £53.6 million (2015: £55.5 million). The fair value of the Prudential Platinum Plan ('Prudential') assets amounts to £62.0 million (2015: £64.9 million).

The company initiated legal proceedings in May 2010 before the High Court in London against the IBM UK Pensions Trustee and two representative beneficiaries of the IBM UK Plans. The company was seeking a declaration that it acted lawfully both in notifying the Trustee of the IBM UK Pension Plans that it was closing its UK defined benefit plans to future accruals for most participants and in implementing the company's new retirement policy. On 4 April 2014, the High Court acknowledged that the changes made to its UK defined benefit plans were within IBM's discretion, but ruled that IBM breached its implied duty of good faith both in implementing these changes and in the manner in which it consulted with employees.

Proceedings to determine remedies were held on 21 July 2014 and, on 20 February 2015, the High Court held that for IBM to make changes to accruals under the plan would require a new consultation of the participants, but to make other changes (including to the early retirement policy) would not require such consultation.

IBM United Kingdom Limited has appealed both the breach and remedies judgements, and the hearing before the Court of Appeal took place in May 2017. The Court of Appeal has not delivered its judgment. There are a wide range of potential outcomes in this litigation, and no certainty as to outcome. If the appeal is unsuccessful, and subject to any further appeals, the Court's rulings would require IBM to reverse one or more of the changes made retroactive to their effective dates. Having taken appropriate advice from our actuaries, our best estimate of the income statement charge that would be incurred should the company's appeal be unsuccessful is £235 million.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 24 Retirement benefits (continued)

IBM believes that it has reasonable prospects of success on appeal, and, therefore, has not made any adjustment to the financial statements.

In addition, IBM United Kingdom Limited is a defendant in approximately 290 individual actions brought since early 2010 by participants of the defined benefits plans who left the company. These actions, which allege constructive dismissal and age discrimination, are pending before the Employment Tribunal in Southampton UK. We do not believe it probable that a material economic outflow will result from the Employment Tribunals and therefore no adjustments have been made to the financial statements.

#### Governance

The Board of Directors of the Trustee Company, IBM United Kingdom Pensions Trust Limited, is responsible for the management of the Plan benefits, the design of the investment strategy and objectives and monitoring the assets of defined benefit plans to ensure that they achieve their fundamental objective of meeting pension liabilities as they become due. The Board of Directors of the Trustee Company also ensures that both defined benefit and defined contribution assets are administered according to specific legislation and plan documentation.

The Governance Committee is responsible for monitoring Plan risks and compliance and monitoring Trustee effectiveness.

The Investment Committee, which is supported by independent investment advisors, ensures that the defined benefit and defined contribution funds meet their objectives. The Investment Committee approves and monitors policies and activities, such as investment policy, asset mix policy, performance benchmarks and objectives, investment strategies, active/passive policy target mix and delegation of authorities. The allocation of assets among various types of asset classes and the performance of investments held by defined benefit trusts (funds) are monitored by the Pensions Trust management on a monthly basis and reviewed by the Investment Committee on a quarterly basis. The portfolios are managed and reviewed on a daily basis by external investment managers based on the policies, targets and benchmarks established by the Investment Committee.

The Benefit Allocation Committee reviews and approves benefits payable to dependants of recently deceased Plan members.

The Dispute Resolution Committee meets, when required, to review complaints made by plan members together with any other related matters referred to it by the Trustee Board, and to make recommendations in respect of these matters to a meeting of the full Trustee Board of the Plan.

#### General risks

The Company's obligations under defined benefit plans statutory minimum funding requirements may significantly vary depending on a number of market, economic, and demographic conditions, such as yields on government and corporate debt, return on plan assets invested in debt and equity securities as well as pooled funds, employee turnover and retiree mortality rates.

These risk factors may affect the company's future cash outflows to fund its obligations, amounts of periodic benefit costs used in calculating net profit and re-measurement charges reported in other comprehensive income.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 24 Retirement benefits (continued)

#### *Asset volatility*

The plan liabilities are calculated using a discount rate set with reference to corporate bond yields; if plan assets underperform this yield, this will create a deficit. The plans' assets are broadly diversified and invested in developed world and emerging market equities, UK and overseas bonds and index linked gilts, UK property, reinsurance and private equity. In addition, to help minimise volatility in the value of the investments, the Trustee uses derivatives to hedge a proportion of its currency risk and interest rate and inflation rate risks.

#### *Changes in bond yields*

A decrease in corporate bond yields will increase plan liabilities, although this will be partially offset by an increase in the value of the plans' bond holdings.

#### *Inflation risk*

The pension obligations are linked to inflation, and higher inflation will lead to higher liabilities. The majority of the plan assets are either unaffected by (fixed interest bonds) or loosely correlated with (equities) inflation, meaning that an increase in inflation will also increase the deficit.

#### *Life expectancy*

The plans' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the plans' liabilities.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 24 Retirement benefits (continued)

Amounts recognised in the Statement of Financial Position and movement over the years:

#### Defined benefit obligation

	2016 £m	2015 £m
Present value of defined benefit obligation at beginning of year	(7,250.2)	(7,435.2)
Current service cost	(6.3)	(8.1)
Interest cost	(250.6)	(257.3)
Contributions by plan participants	(0.4)	(0.6)
Actuarial gain - experience	79.8	116.8
Actuarial (loss) / gain - financial assumptions	(1,082.0)	18.8
Actuarial loss - demographic assumptions	(55.2)	-
Benefits paid	345.8	317.8
Past service cost	(5.0)	(2.4)
<b>Present value of defined benefit obligation at end of year</b>	<b>(8,224.1)</b>	<b>(7,250.2)</b>

#### Fair value of plan assets

	2016 £m	2015 £m
Fair value of plan assets at beginning of year	7,529.8	7,660.4
Interest income	261.7	266.5
Return on plan assets	1,496.7	(168.6)
Contributions by the employer	83.7	94.8
Contributions by plan participants	0.4	0.6
Benefits paid	(345.8)	(317.8)
Administration costs	(4.6)	(6.1)
<b>Fair value of plan assets at end of year</b>	<b>9,021.9</b>	<b>7,529.8</b>

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 24 Retirement benefits (continued)

#### Amounts recognised in the income statement

	2016 £m	2015 £m
Current service cost	6.3	8.1
Past service cost	5.0	2.4
<b>Employee expense (note 7)</b>	<b>11.3</b>	<b>10.5</b>
Administration costs	4.6	6.1
Interest cost on obligation	250.6	257.3
Interest income on plan assets	(261.7)	(266.5)
<b>Net interest on defined benefit asset</b>	<b>(11.1)</b>	<b>(9.2)</b>
<b>Defined benefit expense in the income statement</b>	<b>4.8</b>	<b>7.4</b>
<b>Defined contribution expense in the income statement</b>	<b>84.9</b>	<b>84.1</b>

#### Amounts recognised in other comprehensive income

	2016 £m	2015 £m
Remeasurement gains / (losses) on plan assets	1,496.7	(168.6)
Remeasurement (losses) / gains on plan liabilities	(1,057.4)	135.6
<b>Gains / (losses) recognised in other comprehensive income</b>	<b>439.3</b>	<b>(33.0)</b>
Cumulative remeasurement losses recognised in other comprehensive income at the start of the year	(554.8)	(521.8)
<b>Cumulative remeasurement losses recognised in other comprehensive income at the end of the year</b>	<b>(115.5)</b>	<b>(554.8)</b>



# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 24 Retirement benefits (continued)

#### Fair value and composition of plan assets

The table below analyses plan assets carried at fair value, by valuation method. The different levels have been defined in note 23.

The fair value and composition of plan assets is as follows:

	2016 Level 1 £m	2016 Level 2 £m	2016 Level 3 £m	2016 Total £m
<b>Equity</b>				
Equity securities	924.4	516.7	258.3	1,699.4
<b>Fixed Income</b>				
Government securities	-	3,477.3	-	3,477.3
Corporate bonds	-	728.3	-	728.3
Unit trust bonds	-	1,369.6	-	1,369.6
Other fixed income	8.0	29.0	-	37.0
<b>Cash and cash equivalents</b>				
Cash and cash equivalents	10.6	453.7	-	464.3
<b>Others</b>				
Real estate	-	-	310.6	310.6
Private equity	-	-	285.5	285.5
Other	-	649.9	-	649.9
<b>Total market value of assets</b>	<b>943.0</b>	<b>7,224.5</b>	<b>854.4</b>	<b>9,021.9</b>

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 24 Retirement benefits (continued)

	2015 Level 1 £m	2015 Level 2 £m	2015 Level 3 £m	2015 Total £m
<b>Equity</b>				
Equity securities	947.0	757.0	206.6	1,910.6
<b>Fixed interest</b>				
Government securities	-	2,912.8	-	2,912.8
Corporate bonds	-	595.0	-	595.0
Unit trust bonds	-	1,127.4	-	1,127.4
Other fixed income	-	2.4	-	2.4
<b>Cash and cash equivalents</b>				
Cash and cash equivalents	7.1	97.7	-	104.8
<b>Others</b>				
Real estate	-	-	345.8	345.8
Private equity	-	-	222.5	222.5
Other	-	308.5	-	308.5
	954.1	5,800.8	774.9	7,529.8

Scheme assets do not include any of the company's financial instruments or property occupied, or assets used, by the company.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 24 Retirement benefits (continued)

#### Significant actuarial assumptions

The main assumptions for the tri-annual funding valuations are shown on page 67 and the main assumptions for the current year IAS 19 valuation are as follows:

	2016 %	2016 %	2016 %
	Main Plan	I Plan	Prudential
Discount rate	2.50	2.60	2.70
Retail price inflation assumption	2.90	2.90	2.90
Consumer price inflation assumption	2.00	2.00	2.00
Rate of salary increase	2.50	2.50	2.50
<b>Pension increases for in-payment benefits</b>			
- accrued before 6 April 1997 (until 2020)	1.45	2.90	-
- accrued before 6 April 1997 (thereafter)	-	2.90	-
- accrued between 6 April 1997 and 5 April 2005	2.00	2.90	-
- accrued after 5 April 2005	2.00	2.90	2.90
<b>Pension increases for deferred benefits</b>			
- accrued before 6 April 2009	2.00	2.00	-
- accrued after 5 April 2009	2.00	2.00	2.90

	2015 %	2015 %	2015 %
	Main Plan	I Plan	Prudential
Discount rate	3.50	3.75	3.75
Retail price inflation assumption	2.90	2.90	2.90
Consumer price inflation assumption	2.20	2.20	2.20
Rate of salary increase	2.70	2.70	2.70
<b>Pension increases for in-payment benefits</b>			
- accrued before 6 April 1997 (until 2020)	1.45	2.90	-
- accrued before 6 April 1997 (thereafter)	-	2.90	-
- accrued between 6 April 1997 and 5 April 2005	2.20	2.90	-
- accrued after 5 April 2005	2.20	2.90	2.90
<b>Expected future pension increases</b>			
- accrued before 6 April 2009	2.20	2.20	-
- accrued after 5 April 2009	2.20	2.20	2.90

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 24 Retirement benefits (continued)

The actuarial valuation incorporates mortality assumptions in line with published statistics. The base tables adopted are the standard tables SAPS "S1" Light for males and Light for females with improvements up to 2013 in line with the CMI medium cohort projections. The mortality assumptions for the current year IAS19 valuation are as follows:

	2016 Years	2015 Years
<b>Longevity at age 65 for current pensioners</b>		
- Men	88.5	88.6
- Women	91.4	91.1
<b>Longevity at age 65 for future pensioners</b>		
- Men	90.5	90.8
- Women	93.7	93.4

### Sensitivities

The sensitivity analyses below have been determined on the basis of reasonably possible changes in actuarial assumptions at the end of the reporting year while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated.

	Main Plan	I Plan	Prudential
<b>Discount rate</b>			
0.25% increase	(254.0)	(56.0)	(2.5)
0.25% decrease	270.0	61.0	2.7
<b>Mortality</b>			
Increase of 1 year in expected lifetime of participant at age 65	220.0	39.0	1.8

### Expected contributions

The expected contributions to defined benefit pension funds for the next reporting year after the company's reporting date are:

	£m
Contributions by the employer	56.2
Contributions by plan participants	0.4
	56.6

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

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### 24 Retirement benefits (continued) Maturity Profile

The duration of defined benefit pension obligations at the end of the reporting year on 31 December were as follows:

	Main Plan	I Plan
Duration of the plans	15 years	22.2 years

### 25 Share-based payments

Share-based incentive awards are provided to employees for shares in the ultimate parent company, International Business Machines Corporation, under the terms of the plans. Shares in the ultimate parent company are denominated in US dollars.

During the year the company recognised total expenses, excluding deferred tax, of £17.8 million (2015: £18.1 million) related to equity-settled share-based payment transactions.

#### Share options

Share options are awards which allow the employee to purchase shares of International Business Machines Corporation at a fixed price. They are granted at an exercise price equal to or greater than the ultimate parent company's share price at the date of the grant. These awards, which generally vest 25 percent per year, are fully vested four years from the date of grant and have a contractual term of 10 years.

Under the terms of the arrangement with International Business Machines Corporation, the intercompany payment made and offset to equity against retained earnings in respect of the difference between the market value of the underlying shares on exercise date and the proceeds from exercise of the share options is £0.9 million (2015: £3.6 million).

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 25 Share-based payments (continued)

Details of the number of share options and the weighted average exercise price outstanding during the year are as follows:

	No. (‘000)	2016 Weighted average exercise price £	No. (‘000)	2015 Weighted average exercise price £
Outstanding at the beginning of the year	13	64.43	44	62.78
Exercised during the year	(7)	66.17	(31)	65.01
Expired during the year	-	-	(4)	66.63
Transferred out during the year	(1)	70.04	-	-
Transferred in during the year	-	-	4	66.63
<b>Outstanding at the end of the year</b>	<b>5</b>	<b>83.31</b>	<b>13</b>	<b>64.43</b>
Exercisable at the end of the year	5	83.31	13	64.43

Options transferred during the year relate to employees assigned to and from other countries.

The weighted average share price at the date of exercise for share options exercised during the year was £112.66 (2015: £101.45).

The range of weighted average exercise prices for share options outstanding is disclosed below:

Range of exercise prices	Weighted average exercise price \$	No. (‘000)	2016 Weighted average remaining life: contractual years	Weighted average exercise price \$	No. (‘000)	2015 Weighted average remaining life: contractual years
\$61 - \$85	-	-	-	82.76	5	0.35
\$86 - \$105	102.80	5	0.35	102.80	8	1.35
		5			13	

During the year no share options were granted (2015: no share options).

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 25 Share-based payments (continued)

#### Share awards

In addition to share options, the company grants its employees share awards. These awards are made in the form of Restricted Stock Units (RSUs). RSUs are share awards that are granted to employees and entitle the holder to shares of International Business Machines Corporation's common stock as the award vests, typically over a two-to-five year period. The fair value of the award is determined and fixed on the grant date based on International Business Machines Corporation's share price. For RSUs awarded after 31 December 2007, dividend equivalents will not be paid. The fair value of such RSUs is determined and fixed on the grant date based on International Business Machines Corporation's share price adjusted for the exclusion of dividend equivalents.

Details of the number of RSUs outstanding during the year are as follows:

	2016 No. ('000)	2015 No. ('000)
Outstanding at the beginning of the year	502	486
Granted during the year	229	256
Released during the year	(134)	(215)
Forfeited during the year	(43)	(52)
Transferred during the year	(4)	27
<b>Outstanding at the end of the year</b>	<b>550</b>	<b>502</b>

RSUs transferred during the year relate to employees assigned to and from other countries.

The weighted average fair value of RSUs granted during the year was £97.64 (2015: £95.17).

#### Employee Share Purchase Plan

The company maintains an Employee Share Purchase Plan (ESPP). The ESPP enables eligible participants to purchase full or fractional shares of International Business Machines Corporation through payroll deductions at a 5% deduction from fair value.

In relation to the ESPP, £0.2 million (2015: £0.3 million) was recognised in the income statement during the year.

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 26 Operating lease commitments

At the reporting date, the company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	Land and buildings £m	2016 Other items £m	Land and buildings £m	2015 Other items £m
Within 1 year	35.1	11.1	36.5	12.5
Within 2 to 5 years	53.5	9.9	77.1	11.2
After more than 5 years	3.2	-	9.4	-
	91.8	21.0	123.0	23.7

At the reporting date the total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases amounted to £nil (2015: £nil).

### 27 Contingencies

The company has contingent liabilities in respect of bank and contractual performance guarantees, including on behalf of other group companies, and other matters arising in the normal course of business. No material liability is expected to arise in respect of these arrangements.

The fair value of the performance guarantees at the year end is £nil (2015: £nil).

The company initiated legal proceedings in May 2010 before the High Court in London against the IBM UK Pensions Trustee and two representative beneficiaries of the IBM UK Trust Plans. See note 24 for further details.



# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 28 Events after the reporting date

Subsequent to year end, the company repurchased 3 preference shares for cash consideration of £120 million.

### 29 Notes to the cash flow statement

#### Reconciliation of profit for the year to net cash inflow from operating activities

	2016 £m	2015 £m
<b>Profit for the year</b>	<b>61.2</b>	<b>149.8</b>
<b>Adjustments for:</b>		
Depreciation	68.1	75.0
(Gain) / loss on disposal of property, plant and equipment	(0.4)	0.4
Loss on liquidation	47.4	31.6
Loss on disposal of investment	-	7.5
Difference between pension charge and cash contribution	(67.7)	(78.2)
Finance income	(20.0)	(19.5)
Finance cost	5.7	5.2
Income from investments	(46.4)	(38.5)
Difference between share based payment charge and cash contribution	(0.9)	(3.6)
Income taxes	64.5	41.0
<b>Changes in operating assets and liabilities:</b>		
Increase in trade and other receivables	(28.4)	(81.4)
Increase in trade and other payables	29.8	90.7
Increase in inventories	(11.0)	(0.6)
Decrease in provisions	(3.6)	(39.6)
<b>Cash generated from operations</b>	<b>98.3</b>	<b>139.8</b>
Interest paid	(5.7)	(5.3)
Income tax paid	(84.1)	(1.0)
<b>Net cash inflow from operating activities</b>	<b>8.5</b>	<b>133.5</b>

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 30 Related party transactions

Related parties include parent companies, entities under common control ('group undertakings'), subsidiaries and key management personnel. The company enters into transactions with related parties in the ordinary course of business for the purchase or sale of goods and services provided to and from related parties, purchase of investments from related parties, in relation to group funding arrangements with related parties and in relation to the factoring of trade receivables with related parties. Receivables from related parties also arise from group relief. The group relief receivable arises on the surrender of company losses to other group companies which are used in that company's tax return.

The following transactions were carried out with related parties, and were made on commercial terms and conditions:

Class of related party	Transaction type	2016	2015
		£m	£m
Fellow subsidiary undertakings	Interest receivable	0.5	0.2
	Purchase of trade and assets	4.1	-
	Interest payable	(0.4)	-
Group undertakings	Sales	798.9	782.6
	Purchases	(1,768.5)	(1,665.5)
	Interest payable	(5.3)	(5.0)
	Interest receivable	5.5	6.2
	Sales of trade receivables	2,423.4	2,228.0
	Purchase of investments (note 14)	0.2	-
	Purchase of intangible assets (note 13)	2.9	-
Immediate parent	Interest receivable	2.9	3.8
	Purchase of investments (note 14)	1.9	-
	Purchase of intangible assets (note 13)	22.5	-

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 30 Related party transactions (continued)

Details of the amounts receivable from and payable to related parties are set out below:

#### Receivables from related parties

	2016 £m	2015 £m
Immediate parent	519.6	516.7
Fellow subsidiary undertakings	70.4	78.7
Group undertakings	2,052.3	2,143.3
Less: provision for impairment of receivables from related parties (i)	-	(56.5)
	2,642.3	2,682.2

Included in amounts receivable from related parties is £2,443.0 million (2015: £2,489.0 million) which is interest bearing.

Included within amounts owed by group undertakings is £1,400.0 million (2015: £nil) of amounts held on long term deposit.

Included within amounts owed by group undertakings is £467.0 million (2015: £1,915.8 million) of amounts held on short term deposit. This is included as cash and cash equivalents in the statement of cash flows.

(i) Movement in the provision for impairment of related party receivables:

	2016 £m	2015 £m
Balance at the beginning of the year	(56.5)	(67.6)
Impairment losses reversed on receivables from related parties	56.5	11.1
	-	(56.5)

The impaired related party receivable was repaid in full in July 2017 and, as such, the impairment loss has been reversed.

#### Payables to related parties

	2016 £m	2015 £m
Fellow subsidiary undertakings	476.3	514.8
Group undertakings	455.9	398.1
	932.2	912.9

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 30 Related party transactions (continued)

Included in amounts payable to related parties is £10.9 million (2015: £nil) which is interest bearing.

The amounts outstanding on these balances are unsecured and will be settled in cash. No guarantees have been given or received.

#### Derivative from related parties

	2016 £m	2015 £m
Group undertakings	21.2	9.0

A group undertaking has a 12 month forward rolling hedging programme on behalf of the company to hedge a proportion of its US dollar costs arising from transactions with both related companies and suppliers. The basis of valuation of this is disclosed in note 23.

#### Key management compensation

Key management (including directors) have been determined to be the lead management of each of the lines of business in the United Kingdom. Members of key management are remunerated by the company. The total remuneration of members of key management paid by the company in the year in respect of services to the company was as follows:

	2016 £m	2015 £m
Short-term employee benefits	6.3	5.9
Post-employment benefits	0.4	0.4
Share-based payment benefits	2.0	2.0
	8.7	8.3

Aggregate key management personnel benefits under long term incentive schemes were £nil (2015: £nil).

# IBM United Kingdom Limited

## Notes to the Financial Statements

For the Year Ended 31 December 2016

### 31 Share capital

Allotted, called up and fully paid

	Number of shares	Ordinary shares £m	Preference shares £m	Share premium £m	Total £m
At 1 January 2015	956,427,059	956.4	-	719.3	1,675.7
<b>At 31 December 2015</b>	956,427,059	956.4	-	719.3	1,675.7
Issue of preference shares	2	-	-	24.4	24.4
<b>At 31 December 2016</b>	<b>956,427,061</b>	<b>956.4</b>	<b>-</b>	<b>743.7</b>	<b>1,700.1</b>

During the year the company issued two preference shares, par value £1, for a premium of £24.4 million to acquire Silverpop Systems Limited. These new shares have the same rights as the other preference share capital.

In the event of a winding up the holder of the preference shares shall be entitled to £1 per share, the issued share premium paid and any declared but unpaid dividends. The payment of a dividend on the preference shares is at the discretion of the directors of the company. The company has the right at any time to redeem all or any preference shares for an amount equal to its fair market value.

The holder of the preference shares has no right to vote at meetings, unless the business of the meeting includes a resolution for the liquidation of the company, a reduction of the capital of the company or a resolution adversely altering any of the special rights and privileges attached to the preference shares.

### 32 Ultimate parent company

The company's immediate parent undertaking is IBM United Kingdom Holdings Limited, which holds 89% of the shares and is registered in England and Wales.

The company's ultimate parent undertaking and controlling party is International Business Machines Corporation which is incorporated in the United States of America and is the parent undertaking of the smallest and largest group to consolidate these financial statements. Copies of the financial statements of this undertaking may be obtained from IBM Corporate Headquarters, New Orchard Road, Armonk, New York 10504.